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SUPREME COURT OF THE UNITED STATES

October Term, 1937

No. 313

LONE STAR GAS COMPANY, *Appellant*,

vs.

STATE OF TEXAS, ET AL., *Appellees*

Appeal from the Court of Civil Appeals, Third Supreme Judicial District of Texas

---

BRIEF FOR APPELLANT

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Appeal from the Court of Civil Appeals, Third Supreme Judicial District of Texas

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BRIEF FOR APPELLANT

Introductory Statement.

This is an appeal from a final judgment of the Court of Civil Appeals for the Third Supreme Judicial District of Texas, sustaining a rate order of the Railroad Commission of Texas, challenged by

appellant as being repugnant to the Commerce Clause and to the Due Process Clause of the Fourteenth Article of Amendment to the Constitution of the United States.

The appellant is a gas pipe line company engaged in the business of producing, selling, transporting and delivering gas in wholesale quantities to distributing companies at city gates in Oklahoma and Texas. By the challenged rate order the Railroad Commission reduced appellant's prevailing city gate rate of 40¢ per MCF, applied by it under contracts with the distributing companies, to 32¢ per MCF, and directed that the reduced rate be applied to all city gate delieveries of gas in Texas, including

(a) gas produced or purchased in Wheeler County, Texas, and transported by appellant through the State of Oklahoma and back into Texas for delivery at city gates in Texas; and

(b) gas produced or purchased in Oklahoma and transported by appellant to city gates in Texas.

I.

Opinions of the Court Below.

The opinions of the Courts of Civil Appeals of Texas are no longer officially reported. The opinion of the Court of Civil Appeals in this case is unofficially reported as State of Texas, et al, vs. Lone Star Gas Company, 86 S. W. (2d) 484. The Court's opinion filed in overruling appellant's motion for rehearing is reported under the same title, 86 S. W. (2d) 506.

II.

Jurisdiction of the Court.

This Court has jurisdiction of this appeal under Section 237 of the Judicial Code, as amended; USCA, Title 28, Section 344(a).

Appellant duly filed its Statement as to Jurisdiction, as required by Paragraph 1 of Rule 12, as amended. No opposing statement was filed by appellees. Probable jurisdiction was noted by order entered October 11, 1937.

The specific claims advanced and the rulings made in the State court which are relied upon as the basis of this Court's jurisdiction, together with a specification of such of the assigned errors as are intended to be urged, are hereinafter presented, *infra*, pp. 51-60.

The opinion of the State court expressly shows that the Federal questions presented in this Court were raised in, and were duly considered and decided by, the State court. (V, R. 3334, 3335, 3370.)*

III.

Statement of the Case.

The suit involved the validity of an order of the Railroad Commission of Texas prescribing the maximum rates that may be collected by appellant for gas sold and delivered by it in wholesale quantities to distributing companies at the city gates of

*In making references to the record we shall refer first to the number of the volume and then to the page.

approximately 275 cities and towns in the State of Texas.

Appellant was incorporated under the laws of the State of Texas on June 4, 1909. It has acquired and now owns and operates not only pipe lines, compressor stations, and other equipment necessary for the transportation and sale of natural gas but also gas leases, gas wells, well drilling equipment, and other property used as a part of its production system. It operates approximately 4,000 miles of high pressure pipe lines, located in Oklahoma and Texas, through which it transports natural gas to the city gates of more than 300 cities and towns located in the States of Oklahoma and Texas, where it sells and delivers such gas in wholesale quantities to gas distributing companies operating therein. (I, R. 15.) The distributing companies then deliver the gas to ultimate consumers through low pressure systems. The distributing companies, with the exception of two companies, one operating at Waxahachie and the other at Gainesville, Texas, are corporations affiliated with the appellant, being subsidiaries of the same parent corporation. The appellant makes two city gate deliveries at Waxahachie, one to an independent corporation and the other to an affiliated corporation. (IV, R. 2312, 2342.) The distributing company at Gainesville is an independent corporation. (V, R. 3340.)

The sale and delivery by appellant of gas at city gates to distributing companies is governed by long term contracts between appellant and such companies, and the contract price is 40¢ per MCF, with negligible exceptions. The deliveries to the affiliated

companies are made under substantially the same kind of contracts and in the same manner as are the deliveries made to the independent companies. (IV, R. 2306-2356.)

Appellant's pipe line system crosses the State line between Oklahoma and Texas eight times. A map showing the location of appellant's lines in Oklahoma and Texas is appended hereto.

Three of its lines, designated as Lines H, 2nd H, and G, transport gas from Oklahoma to Texas—gas previously produced or purchased in Oklahoma. (II, R. 1464.) Another line, designated as Line A, extends from the Shamrock gas field in Wheeler County, Texas, (a part of the great Texas Panhandle gas field) into Oklahoma and then runs south through Oklahoma approximately parallel to the west line of Oklahoma and again crosses the State line, coming again into Texas near Quanah, Texas. (II, R. 1465.) The line then extends generally in a southeasterly direction through Texas to Petrolia, Texas, where it joins Lines H and 2nd H coming from Oklahoma. (II, R. 1465.) Line A furnishes the exclusive supply of gas, delivered at city gates, to many cities and towns located on the line, including the important city of Wichita Falls. After this line reaches Texas it is tapped by a branch line extending north again into Oklahoma and serving various Oklahoma cities. (II, R. 1468.) Appellant also has two other lines extending from Texas northward into Oklahoma and serving certain Oklahoma cities and towns, these being designated as Line E-5 and Line E-16. (II, R. 1471, 1476.)

A map showing the location of appellant's lines in Oklahoma and Texas is appended hereto.

An applicable Texas statute subjects gas pipe lines to the "jurisdiction, control and regulation" of the Railroad Commission of Texas *(Art. 6050, Revised Civil Statutes of Texas, 1925)*. The commission is authorized to fix reasonable prices and rates "for producing, transporting, selling and delivering gas by such pipe lines." *(Art. 6053, Revised Civil Statutes of Texas, 1925.)** The challenged order was promulgated under Article 6053.

1. The Challenged Order.

After investigation and hearing the Railroad Commission of Texas, on September 13, 1933, entered its order reducing appellant's wholesale city gate rate, as fixed by its contracts with the distributing companies, from 40¢ to 32¢ per MCF. The order follows:

"The Railroad Commission having instituted a proceeding upon its own motion inquiring into the rates charged by the Lone Star Gas Company for domestic gas sold to distributing companies at the city gate station, hereby finds as a fact that the rate of $0.40 per thousand cubic feet as now charged by Lone Star Gas Company is unfair, unjust and unreasonable.

"Basing its order on the foregoing finding of fact and on such other findings and statements of fact as are set out in the opinion next preceding this order, or in this order

*These and other Texas statutes relating to gas utilities and their regulation are set forth in Appendix "A," *infra*, pp. 171-173.

"IT IS ORDERED, ADJUDGED and DECREED that effective as of the next billing date the Lone State Gas Company shall charge, bill and receive for domestic gas at the city gate from all distributing companies served by it, a rate not to exceed $0.32 per thousand cubic feet.

"IT IS FURTHER ORDERED, ADJUDGED and DECREED that a rate not to exceed $0.32 per thousand cubic feet at the city gate is hereby fixed, approved and promulgated and found and declared to be fair, just and reasonable and shall remain in force and effect until the Commission shall have otherwise determined, pursuant to other proceedings in respect to the finding of city gate rates for domestic gas on said Lone Star Gas Company's lines.

"IT IS FURTHER ORDERED, ADJUDGED and DECREED that this proceeding shall be kept open for such further orders as may be proper.

"The foregoing opinion and order are hereby approved and ordered filed as the opinion and order of the Railroad Commission of Texas." (I, R. 116.)

2. The Commission's Findings.

The opinion "*next preceding this order*," and made a part of the order, contains elaborate findings of fact stating in detail how the commission valued appellant's properties, what property was included in the valuation, and what operating revenues were considered and what expense items were allowed as proper deductions from the operating revenues. (I, R. 14-116.)

Pertinent portions of the commission's findings are stated and summarized as follows:

(1) As to the unified nature of appellant's properties and business operations in Oklahoma and Texas the Commission made this finding:

"The Lone Star Gas Company, a Texas corporation, is engaged in the production, transportation and sale at wholesale of natural gas. It operates an integrated pipe line system of approximately 4000 miles and engages in both interstate and intrastate commerce in the selling of gas to some 300 cities and towns within the States of Oklahoma and Texas.

"The company's Texas properties and its Oklahoma properties constitute parts of an integrated operating system. For that reason we have considered the Oklahoma properties and operations and the effect thereof on the revenues and the expenditures within Texas. On this basis we have fixed a rate for application within the jurisdiction of Texas." (I, R. 15.)

Having made this finding, the Commission then proceeded to value appellant's "integrated operating system" and to consider its operating revenues and expenses incident to its "integrated operating system." (I, R. 14-16.)

The year 1931 was used "as a basis for finding the city gate rate which would earn a fair return." (I, R. 16.)

(2) The Commission directed the reduced rate to be applied to all sales and deliveries made by appellant to distributing companies at city gates in Texas, drawing no distinction between interstate and intrastate commerce. (I, R. 116.) The commission found that appellant "engages in both interstate and intrastate commerce in the selling of gas to some 300 cities and towns in the States of Oklahoma and Texas." Apparently, therefore, the commission, in applying its rate to all Texas deliveries, proceeded on the theory that it had the power to prescribe rates

applicable to all of the deliveries, even though some of the deliveries might constitute interstate commerce.

(3) In respect to a rate base, the commission found "a reproduction cost new as of December 31, 1931, for transmission and production properties, exclusive of leaseholds, of $44,606,337.16"; and "a fair value of leaseholds as of December 31, 1931, of $1,991,613.92"; and a rate base of $46,246;617.53. (I, R. 19.)

The rate base findings of the commission are summarized on pp. 66-67 and 100 of the Record, Volume I. The book cost of appellant's integrated operating system was found by the commission to be $47,696,533.11, as of December 31, 1931. (I, R. 109.) This did not include material and supplies, cash working capital, or going concern value.

(4) The commission found gross revenues for the year 1931 in the amount of $9,301,862.65. Total expenses for the year were found to be $4,174,807.47, leaving $5,127,055.18 available for depreciation, depletion and return on the producing and transmission properties. (I, R. 18.)

(5) Annual reserve accruals for depreciation and depletion were fixed on a 6% sinking fund basis and amounted to $968,066.98 for depreciation and $15,631.45 for depletion. This allowance amounts to approximately 2% of the rate base found by the commission. (I, R. 19.) Detailed findings as to depreciation will be found in I, R. 76-98, and as to depletion, I, R. 99.

(6) Having found $5,127,055.18 available for depreciation, depletion, return and Federal income taxes for the year 1931, the commission deducted therefrom depreciation in the amount of $968,066.98, and thereby found $4,158,988.20 as the amount available for depletion, Federal income taxes and return for the year 1931. By deducting $15,631.45 for depletion, it found $4,143,356.75 as the amount available for return and Federal income taxes for the year 1931, on appellant's integrated operating system. (I, R. 99.)

(7) The commission found "a minimum fair rate of return for the year 1931 to be 6%," and that this amounted to $2,774,797.05 when applied to the rate base as of December 31, 1931. It then computed excess of net earnings over a 6% return at $1,368,559.70, which amounted to 8.039¢ per MCF on the domestic gas sold during 1931. On this basis it was determined that the 40¢ gate rate charged by appellant should be reduced 8¢ per MCF and a rate of 32¢ per MCF established in its place. (I, R. 102-105.)

3. Proceedings in the United States District Court.

The rate order was promulgated September 13, 1933. On September 22, 1933, appellant filed a suit in the District Court of the United States for the Western District of Texas, wherein it sought to enjoin the Railroad Commission and the Attorney General of Texas from enforcing said order, and wherein it attacked the validity of the order on the ground that it amounted to a direct regulation of appel-

lant's deliveries of gas in interstate commerce, in violation of the Commerce Clause of the Federal Constitution, and on the further ground that the prescribed rate was confiscatory and violative of the Due Process Clause of the Fourteenth Amendment to the Federal Constitution. (III, R. 2183-2207.) The United States District Court issued an order temporarily restraining the enforcement of the order.

Thereafter, this suit was filed by appellees in the Fifty-third District Court of Travis County, Texas, in an effort to fix jurisdiction in that court, under the provision of Section 266 of the Judicial Code; the appellees alleging in their pleadings, upon which the trial was had, that they desired to have the constitutional questions raised by appellant in its attack on the rate order determined in the courts of the State. They further sought to have the commission's rate order enforced. (I, R. 12.) In the State court appellees sought an injunction, upon final hearing, restraining appellant from violating the rate order; and further prayed that the enforcing of said rate order be stayed pending final judgment. (I. R. 11.) A stay order was entered in the State court; (I, R. 121); and subsequently the Federal court, following what it deemed to be proper procedure under Section 266 of the Judicial Code, entered an order staying all proceedings in that court and also restraining the enforcement of the rate order pending final determination of the case filed in the State courts. (I, R. 117-121.)

Perforce these stay orders of the State and Federal courts, the 32¢ rate prescribed in the commission's

order has not been put into effect and appellant has continued to charge the 40¢ rate.

4. Proceedings in the State Trial Court.

Appellant, after unsuccessfully resisting the procedure resorted to by appellees to force it to litigate its attack on the commission's order in the State courts, and reserving its exceptions, (I, R. 136), answered in the State court, setting up its defense and grounds of attack upon the rate order and the trial was there had on Appellant's Second Amended Answer (I, R. 122-161) and its Second Supplemental Answer (I, R. 161-170).

(1) *The Pleadings.*

Appellant's grounds of attack on the rate order were:

That the transportation, sale and delivery by appellant at wholesale to local distributing companies, through high pressure lines at city gates in Texas, of gas produced in Wheeler County, Texas, and transported into and through Oklahoma and back into Texas without interruption, constituted interstate commerce, and that the attempted regulating and fixing of appellant's city gate rates for the gas thus transported, sold and delivered violated Cl. 3 of Article I of the Constitution of the United States, vesting in Congress the power to regulate commerce among the several States; and that the same was true of the gas produced or purchased by appellant in the State of Oklahoma and transported in high pressure lines to Texas for sale and delivery at city gates in Texas. (I, R. 123-124; 131-132; 147-151.)

That the prescribed rate was confiscatory and therefore repugnant to the Due Process Clause of the Fourteenth Amendment to the United States Constitution. (I, R. 147-151.) The facts upon which the appellant based its claim that the rate order was confiscatory were specifically alleged.

These allegations cover the value of appellant's property (I, R. 141, 146); the elimination by the commission of property used and useful in rendering the public service for which the rate was charged, including capital additions to such properties made the year 1932 and costing $2,257,682.07 (I, R. 142); the book cost of the property (I, R. 141, 146); the amount required to be annually set aside to reserve for depreciation, depletion and amortization as against the commission's allowance (I, R. 138); and the amount available under the 40¢ rate; and that the amount of revenue available for return, after making all proper deductions, was so low as to show beyond doubt that the prescribed rate was confiscatory. (I, R. 145.)

We deem it unnecessary to go further into the details of appellant's pleadings. That the Federal rights and defense it now claims were expressly and sufficiently pleaded has not been denied. The opinion of the State court expressly shows that the Federal rights and defenses now asserted by appellant were duly asserted in the State courts.

(2) *The Evidence.*

The trial was entirely *de novo*. The record of the evidence heard by the commission was offered in evidence by appellees but was not received by the trial court.

Appellees, as plaintiffs in the trial court, introduced the commission's order; the stay order of the Federal Court; and a stipulation that the prescribed rate had not been put into effect, and rested their case. (I, R. 301-309, 310.) The commission's findings were later introduced in evidence by appellant to show the basis for the commission's order. The order recites that it was based on the findings and they were made a part of it. (I, R. 116.) Appellant's motion for a directed verdict having been overruled, (I, R. 310) it then introduced evidence in support of its attack on the rate order. This included evidence showing the interstate character of its business. This evidence is hereinafter summarized, *infra*, pp. 21-34. It also introduced evidence as to the value of its properties, depreciation reserve accruals, revenues, expenses, rate of return and other facts pertinent to the confiscation issue. This evidence covered appellant's operating experience for the years 1931, 1932, 1933, and the twelve months ended April 30, 1934, the latest date as to which evidence was available at the time of trial.

The evidence thus introduced by appellant dealt, first, with its "integrated operating system"; and was in direct rebuttal of the commission's findings. This evidence is hereinafter summarized, *infra*, pp. 34-43. Appellant's evidence dealt next with its properties and business operations as segregated by the appellant between interstate and intrastate commerce or service; and this evidence is hereinafter summarized, *infra*, pp. 43-44.

Thereafter appellees undertook to demonstrate that the commission's order would afford a reason-

able return. This was done by segregating what the commission had found to be an "integrated operating system" as between Texas and Oklahoma. The evidence in support of appellees' segregation allocated to Texas the property physically located in Texas and to Oklahoma the property physically located in that State. It excluded the value of all of appellant's production system properties located in Texas, having an actual cost of $5,191,539.42, and also excluded all property in Oklahoma used in producing and transporting gas to points in Texas and substituted therefor arbitrary and inadequate expense allowances hereinafter discussed, *infra*, pp. 44-50. Under this segregation, operating revenues and expenses were similarly segregated as between Oklahoma and Texas. No evidence was offered by the appellees relating to the property constituting the appellant's "integrated operating system" or its value or the amount of net revenues accruing therefrom. No evidence was offered in support of the findings of the commission as they were made, these findings covering, as we have already pointed out, all of appellant's properties and operations as an "integrated system."

We hereinafter separately submit summary statements of the facts affecting the issues involved; *infra*, pp. 21-34; p. 51; pp. 34-50.

(3) *Charge, Verdict and Judgment.*

The case was tried by a jury. The court submitted to the jury the following special issue:

"Do you find from the evidence in this case that, as applied to points in Texas, the order of the Rail-

road Commission of Texas, bearing date of September 13, 1933, providing for a rate of not exceeding 32¢ per thousand cubic feet of gas sold to the distributing companies at the gates of the points served, is unreasonable and unjust as to the defendant Lone Star Gas Company? Answer this question yes or no."

The jury answered: "Yes." (I, R. 192-195.)

In submitting the above special issue the trial court further instructed the jury as follows:

"In determining your answer to said issue, you are instructed that the defendant, Lone Star Gas Company, is entitled to receive a fair return at this time on the present fair value of its property that is used and useful in the public service, after first deducting all necessary operating expenses and a fair and reasonable amount for depreciation of said property; and that, in determining what is a fair value of said property, you will take into consideration the reasonable worth of the property at this time that is being used and useful in the public service, including the reproduction cost new of said property, annual depreciation, and the amount of going value, if any, that inheres in said property." (I, R. 194-195.)

The court further instructed the jury that "an unreasonable and unjust rate" was one "so low as to have not provided for a fair return upon the fair value of defendant's property used and useful in supplying the service furnished by said defendant." (I, R. 194.)

The charge further defined the terms "fair value," "fair return," "used and useful," "operating expenses," "annual depreciation," "reproduction cost new," and "going value." (I, R. 193.)

The jury's verdict, interpreted in the light of the charge, imports that the prescribed rate would not yield a fair return on the fair value of appellant's public service properties and is therefore confiscatory.*

On this verdict the trial court rendered judgment annulling the commission's rate order and enjoining the enforcement of the prescribed rate against appellant. (I, R. 197.)

5. Proceedings in the Court of Civil Appeals.

Appellees then prosecuted their appeal to the Court of Civil Appeals for the Third Supreme Judicial District of Texas. By counter propositions presented in its brief and by cross-assignments of error appellant duly presented its contention that the trial court erred in failing to sustain its interstate commerce defenses, as well as its confiscation defense.† (V, R. 3329-3332.)

On appeal, the Court of Civil Appeals, after stating and discussing at length appellant's interstate commerce and confiscation defenses, overruled same, reversed the judgment of the trial court, dissolved the injunction granted by that Court, and declared the rate prescribed by the commission to be "just,

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*This Court in *United Gas Public Service Company vs. State of Texas, et al.*, (unreported), decided February 14, 1938, interpreted a similar verdict, construed in connection with a similar charge, as expressing a finding on the issue of confiscation. The verdict there was in favor of the commission; here it is in favor of the utility.

†The judgment of the trial court being in favor of appellant, it was not in fact required, under the State practice, to present any cross-assignments of error.

valid and reasonable in every particular." (V, R. 3333-3370.

The Court of Civil Appeals held:

(1) That the transportation by appellant in its high pressure line (designated as Line A) of gas produced or purchased in Wheeler County, Texas, into and through the State of Oklahoma and thence back into Texas for sale and delivery at city gates, in wholesale quantities, "is not interstate commerce as a matter of fact." (V, R. 3345-3348.) In this connection the court further held that appellant's "primary duty is to serve Texas citizens with gas produced from Texas soil" and that "the mere fact that appellee has selected a route through Oklahoma" could not work a change in the character of its business and that "this circuitous route of delivery of gas through Oklahoma" could not affect the police power of Texas "to make or fix reasonable rates" for gas sold in Texas (V, R. 3346-3347); and that, "with this in view but one practical conception can be drawn from the whole transaction involved and that is, the gas produced in Texas and intended to be delivered, sold and used in Texas is intrastate commerce." (V, R. 3346-3347.)

(2) That the transportation in appellant's high pressure Lines H, 2nd H, and G of gas produced or purchased by appellant in the State of Oklahoma and intended for sale and delivery at city gates in Texas does not move in interstate commerce when it reaches the city gates in Texas for delivery. (V, R. 3348-

3352.) In this connection the Court made certain other rulings that will be hereinafter specifically discussed, *infra*, pp. 105-110.

(3) That even though a part of appellant's gas deliveries in Texas may have constituted interstate commerce, the rate order was nevertheless valid as applied to such interstate deliveries because the prescribed rate was, in the view of the court, a reasonable rate; and the court ruled, in this connection, that the prescribing by the State of reasonable rates to be applied to interstate deliveries affects interstate commerce, not directly, but only "incidentally or indirectly." (V, R. 3347, 3350-3352.) The Court held that even if appellant's deliveries constituted interstate commerce, "the 32¢ rate fixed by the Commission in no manner interfered with, impeded or burdened the flow of gas from Oklahoma, but such gas may be sold in competition with Texas gas and at the same reasonable price fixed by the Commission." (V, R. 3352.)

The court, in this connection, emphasized the fact that Congress had not authorized the Interstate Commerce Commission to regulate such rates and had not otherwise provided for their regulation, and held that absent legislation by Congress, "the State Commission, in the exercise of the police power of the State to regulate and control public gas utilities, had the power to fix reasonable rates for gas delivered by appellee to distributing companies at the city gate, although interstate commerce may be indirectly or incidentally affected thereby." (V, R. 3352.)

(4) The court overruled appellant's claim that the prescribed rate was confiscatory, and held, in this connection, that appellant's evidence on the issue of confiscation was legally immaterial and of no probative value because of appellant's alleged failure to make a proper segregation of its properties and business operations as between interstate and intrastate commerce, or as between Oklahoma and Texas operations. The questions arising in this connection and the evidence affecting them are hereinafter discussed, *infra*, pp. 110-124.

(5) The court further made certain rulings relating to the kind of judicial review of rate orders that was available under the State procedure. The court held that the evidence on certain vital issues connected with the ultimate issue of confiscation, including the issue as to the *fair value* of appellant's properties and the issue as to what would be a *fair rate of return*, was merely conflicting and therefore insufficient to sustain the attack on the rate order; that "at most the evidence merely presented the difference of opinions of equally well qualified experts" (V, R. 3363, 3368), and that such evidence was insufficient as a matter of law. The court denied the right of the jury to settle these conflicts in the evidence. These rulings are hereinafter more fully stated and discussed, *infra*, pp. 124-134.

(6) The court made other rulings going to the merits of the issue of confiscation. These are hereinafter stated and discussed, *infra*, pp. 134-170.

More detailed references to the lengthy opinion of

the Court of Civil Appeals will be made in connection with the specific rulings complained of.

6. Proceedings in the Supreme Court of Texas.

Appellant then applied to the Supreme Court of Texas for a writ of error. The application was refused; and motion for rehearing thereon, as authorized by the court's rules, was overruled. (V, R. 3435, 3436.)

This appeal was allowed on February 12, 1937, this being less than three months after the judgment of the State court became final under the State law. (V, R. 3468.) Details as to this were fully presented in Appellant's Statement as to Jurisdiction previously filed and considered by this Court.

IV.

Statement of the Facts Affecting the Questions Raised.

The questions raised on this appeal may be divided into two groups. First, those that grow out of appellant's attack on the rate order on the ground that it amounts to a regulation of *interstate commerce;* and, second, those that relate to appellant's attack on the rate order as being *confiscatory.* Orderly presentation requires that the evidence relating to these two features of the case be separately stated.

1. Statement of the Facts Relating to the Interstate Commerce Questions.

Here there is involved the gas produced or purchased by appellant in Wheeler County, Texas, (hereinafter referred to as the Wheeler County gas) and transported into and through the State of Oklahoma and back into Texas for sale and delivery in wholesale quantities to distributing companies at city gates in Texas. Next there is involved the gas produced or purchased by appellant in the State of Oklahoma and transported to Texas for sale and delivery at city gates to distributing companies.

(a) *The facts relating to the Wheeler County gas transported through Oklahoma into Texas.*

Appellant owns and operates an 18" high pressure gas pipe line, known as Line A, extending from the Shamrock gas field (a part of the Texas Panhandle gas field and referred to in the record either as the Shamrock field or the Wheeler County field), in Wheeler County, Texas, into and through the State of Oklahoma and back into Texas. Through this pipe line appellant transports gas produced or purchased by it in the gas field mentioned to city gates in both Texas and Oklahoma where it is sold and delivered in wholesale quantities to distributing companies operating in said cities. (II, R. 1465-1466.)

This pipe line, starting in the Shamrock gas field in Wheeler County, Texas, follows a southeasterly course, crossing into the State of Oklahoma; and then a southeasterly course through Oklahoma and generally parallel to the western boundary of Oklahoma until it again enters the State of Texas. After entering the State of Texa it extends in a generally southeasterly direction to Petrolia, Texas. The loca-

tion of this line is correctly shown on the map appended to this brief.

The distributing companies operating in the cities of Hollis, in the State of Oklahoma, and Chillicothe, Tolbert, Vernon, Oklaunion, Harrold, Electra, Iowa Park, and Wichita Falls, in the State of Texas, are all supplied directly and exclusively with natural gas transported from the Wheeler County field through this line and delivered at the city gates. (II, R. 1465-1468.) At Oklaunion, Texas, this line is tapped by a branch line that extends northward back into the State of Oklahoma; and this branch line furnishes the sole source of gas supply for distributing companies operating in the cities of Frederick, Tipton, Davidson, Snyder, Manitou, and Mountain Park, in the State of Oklahoma. (II, R. 1466, 1482.)

The Wheeler County gas transported in Line A passes through a gasoline extracting plant at Hollis, Oklahoma. (II, R. 1491.) It does not pass through any gasoline extracting plant in the State of Texas. (II, R. 1478.) The discussion in the opinion of the Court of Civil Appeals relating to the passing of gas through gasoline extracting plants in Texas is applicable, under the undisputed evidence, only to the gas produced or purchased in the State of Oklahoma and transported to Texas in Lines H, 2nd H and G. The facts relating to this gas produced or purchased in Oklahoma and transported to Texas in the three lines mentioned are separately stated, *infra*, pp. 30-34.*

*In stating the facts relating to the interstate commerce issue the Court of Civil Appeals does not clearly separate the facts relating to the Wheeler County gas from the facts relating to the gas produced or purchased in Oklahoma and transported to Texas through Lines H, 2nd H and G.

The Wheeler County gas moves uninterruptedly at high pressure from the time it enters the appellant's main in the Shamrock or Wheeler County field until it is delivered to the various distributing companies purchasing the same at the city gates of the various cities and towns supplied in Oklahoma and Texas. (II, R. 1490.) These deliveries are made under contracts between the appellant and the distributing companies running for a term of five years. These contracts provide for delivery at the city gate measuring stations located at or near the corporate limits of each city or town. These contracts were introduced in evidence. (IV, R. 2306-2362.) They provide that appellant may make deliveries of the gas "at the maximum pressures carried in its pipe line at the various delivery points," and require the distributing companies in each instance to install and operate "such regulators and regulator stations as it may require to regulate the pressure of the gas after delivery thereof by vendor to vendee." These contracts provide that appellant shall in no event be liable for any pressure fluctuation at the delivery points or for the control of gas pressures after delivery. (IV, R. 2308.)*

The movement of the gas, the pressures maintained, and the method of measuring and making delivery of the gas to distributing companies at the city gates are clearly described in the testimony of the witness Schmidt, as follows:

"Q. Mr. Schmidt, will you please relate to the

*We refer to only one of the contracts. The other contracts with distributing companies, both affiliated and independent, contain the same provisions.

jury generally how gas travels from the well to the city gate station where a wholesale delivery is made by the Lone Star Gas Company?

"A. The gas is taken from the well at high pressure and transported through the lines at high pressure to the city gate delivery points. At those points the pressure is reduced through regulators, which are devices for automatically carrying and reducing the high pressure to a low pressure, and at the discharge side of these regulators the gas is measured, and that measurement is the total gas delivered to any particular city. The pressures in the field at the wells and in the pipe lines may vary from 300 to 400 pounds, and at the inlet of the regulators at the city gate stations the pressure varies, depending upon the location or distance of those towns from the source of supply. That pressure will vary from 150 to as high as 300 pounds, or in some cases 350 pounds. The gas travels uninterruptedly from the wells to the delivery points at the city gates.

"Q. To what pressure is the gas transported in the high pressure pipe lines of the company reduced at the city gate measuring stations and for what purpose is that reduction in pressure made?

"A. The pressure is reduced at those city gate stations through the regulators to a pressure there of twenty-five or thirty pounds. This is done in order to supply gas at a pressure which is safe to transport it through the city lines, the city distribution system, and it is done to accommodate the distribution plants in their operations.

"Q. And it is done solely for that purpose, in so far as the Lone Star Gas Company is concerned?

"A. That is correct.

"Q. Where does the title to the gas pass out of or from the Lone Star Gas Company to the local dis-

tributing company at the city gate measuring station?

"A. At the outlet of the meter, which is usually the outlet header of the orifice meter measuring station.

"Q. Is there ever any period of time, Mr. Schmidt, when the gas transported by the company from and through the State of Oklahoma in its high pressure pipe line, when that forward movement of the gas is arrested?

"A. There is not.

"Q. What is the last act of the Lone Star Gas Company in connection with the actual delivery of the gas by it at the city gate to the local distributing company?

"A. The measurement of the gas is the last operation." (II, R. 1469-1470.)

As pointed out by the witness, loss of pressure is an incident of the transportation of the gas. The original pressure decreases as the distance from the point of production increases.

The opinion of the State court refers to the running of gas through gasoline extracting plants and to the use of compressor stations. None of the Wheeler County gas is run through a gasoline extracting plant in Texas. The gasoline content is extracted by running all of it through a plant at Hollis, Oklahoma. (II, R. 1478, 1491.) The discussion in the court's opinion of gasoline plants relates only to the gas produced or purchased in Oklahoma and transported to Texas.

Part, but not all, of this Wheeler County gas is run through a compressor station at Petrolia, Texas. (II, R. 1478.) There is no other compressor station on Line A between the Shamrock field in Wheeler

County, Texas, and Petrolia, Texas. (II, R. 1491.) The original rock pressure is sufficient to transport the gas from the gas field in Wheeler County into and through the State of Oklahoma and, finally, to Petrolia, Texas; a total distance of approximately 185 miles.

The purpose of running gas through a compressor is to boost the pressure and increase the movement of the gas. It is simply a transporting agency. We quote the testimony of the witness Schmidt:

"Q. Now all the gas that comes through Line A goes through the compressor station at Petrolia, does it not?

"A. Not all of it. There are times during the summer time when Petrolia is by-passed, and gas from Line A goes direct down into the lines south of Petrolia.

"Q. But most of the time that gas does go through the compressor plant, doesn't it?

"A. Yes, a good share of the time it does.

"Q. And the pressure is what, when it comes into the plant?

"A. That varies from about 250 pounds to about 100 pounds, or 110, something like that.

"Q. And when it leaves the plant, what is its pressure?

"A. That will vary too, from around 250 pounds to 300 pounds or 325." (II, R. 1478.)

The quantity of the Wheeler County gas transported through Line A for sale and delivery to distributing companies at city gates in Texas, as well as its relation to the total amount of gas transported by appellant, is definitely known. These quantities are shown on appellant's Exhibit 44. (V, R. 3201-

3206.) The evidence shows that city gate deliveries are metered and a record kept.

Appellant's Exhibit 44 gives a five-year summary of the amount of gas transported by Lone Star Gas Company *from* and *through* Oklahoma, beginning with the year 1929 and including the year 1933, as compared with the total gas transported by appellant from all sources. This exhibit shows the percentage for each year of appellant's total deliveries of gas that was transported either from or through Oklahoma as follows:

1929	32.9%
1930	30.7%
1931	26. %
1932	29.6%
1933	23.3%

The weighted average for the five-year period was 28.9%.

The ratio in amount of the gas transported by appellant from the Shamrock field in Wheeler County, Texas, into and through Oklahoma and delivered at Texas city gates to the total amount of gas transported by appellant from all sources for the years 1929 to 1933, inclusive, as can be calculated from the same exhibit, was as follows:

1929	14.8%
1930	16.5%
1931	17. %
1932	23.3%
1933	19.5%

(V, R. 3201-3206.)

It will be noted that, in general, these Wheeler County deliveries are increasing in amount both in Texas and Oklahoma.

This Wheeler County gas is delivered in uncommingled state at all Texas cities on Line A from Chillicothe to Petrolia, including the important city of Wichita Falls; it furnishes the exclusive source of gas supply for these cities. After it reaches Petrolia it is commingled with other gas, some of it coming from Oklahoma and some of it produced in other Texas gas fields. The amount of the Wheeler County gas that is received at Petrolia and is then commingled with other gas is definitely known. (II, R. 1467.)

The commission's rate order fixes a single rate of 32¢ per MCF applicable to all city gate deliveries made on appellant's lines in Texas. The order draws no distinction between interstate and intrastate deliveries at city gates. The commission clearly intended that the order should apply to all deliveries made in Texas. (I, R. 116.) It included all of Line A in the rate base. The State court has directed that the order be so enforced. (V, R. 3333-3370.)

Appellees alleged that appellant's line in Wheeler County, Texas, was routed through Oklahoma for the fraudulent purpose of depriving the Railroad Commission of Texas of the jurisdiction which it would have had over appellant's business if the line had been routed wholly through Texas. (I, R. 156.) The record distinctly negatives the existence of fraud or bad faith in selecting the route for this line; engineering considerations induced the selection of the

route. (Testimony of witness Schmidt, II, R. 1472-1475, 1487-1490, 1493-1496; also *infra*, p. 74.

(b) *The facts relating to the gas produced or purchased by appellant in Oklahoma and transported into Texas.*

Appellant owns and operates a 16" high pressure line, designated as Line G, extending southward from the Loco, Fox, Robertson, and Palacine gas fields, in Stephens and Carter Counties, Oklahoma, and entering the State of Texas at a point north of the City of Gainesville. (II, R. 1464.) The Oklahoma gas produced or purchased in the gas fields referred to is transported in appellant's Line G into Texas for delivery at city gates.

Gas produced or purchased by appellant in the Chickasha, Nellie and Duncan gas fields, in Stephens County, Oklahoma, travels in a southerly direction through appellant's Lines H and 2nd H. These are 12" high pressure lines and enter the State of Texas at a point near Petrolia. (II, R. 1464.)

Gas from Line G is ordinarily the exclusive source of supply of gas for the City of Gainesville (II, R. 1469); and also certain towns north of Gainesville that are supplied from a branch line designated as Line G-3 (II, R. 1468). The towns of Petrolia and Byers are served almost exclusively by Lines H and 2nd H. (II, R. 1468.)

The gas produced and purchased by appellant in Oklahoma and transported to Texas in Line G is run through a gasoline plant at Gainesville, in the State of Texas. (II, R. 1480.) The Oklahoma gas transported in Lines H and 2nd H is run through a gaso-

line absorption plant at Petrolia. (II, R. 1480.) The purpose of this process is to remove certain heavy hydrocarbons. This is done to eliminate operating troubles due to the freezing of these gases and to make the gas more suitable for domestic consumption. (II, R. 1479-1480.)

The treatment to which this gas is subjected in the absorption plants is clearly and accurately stated in the testimony of the witness Schmidt, as follows:

"Q. Now, what is done at the gasoline plants?

"A. At the gasoline plant, certain heavy hydrocarbons are removed and condensed by a method known as an absorption method, and the gas enters the bottom of large cylindrical tanks and comes in touch or in contact with a petroleum oil known as mineral seal oil, which has a high attraction for the hydrocarbons, and by means of this contact the hydrocarbons are then absorbed and the gas passes out of the absorbers directly into the line again, with no interruption.

"Q. Now, after the volatile gasoline, or the heavy hydrocarbons, as you want to call it, is absorbed, the residue gas that is left is of a different composition, isn't it?

"A. The composition is practically the same. There is such a small proportion of these hydrocarbons removed, that the composition is almost identical.

"Q. When you extract gasoline vapors from natural gas, that is present in the line before it goes to the gasoline plant, and then pass on through the residue gas, it has a different heating value, doesn't it?

"A. The heating value is lowered by possibly three per cent, but that is not the entire facts of the matter, because most of the hydrocarbons would con-

dense in the lines anyhow, and you would have the same condition, besides giving us considerable operating troubles; these gases freeze up and cause stoppages in the line." (II, R. 1479.)

The forward movement of the gas is not stopped when it passes through these gasoline plants. We quote the testimony of the witness Schmidt, as follows:

"Q. Now, then, the forward movement is to some extent checked whenever the gas passes through a gasoline plant too; isn't that correct?

"A. It is not.

"Q. Well now, you know that it is stopped to some extent, don't you, Mr. Schmidt?

"A. It does not stop at all.

"Q. Well Mr. Schmidt, does the whole gasoline process not depend upon arresting the forward movement of that gas, and getting it into a static condition, where the vapors can be condensed out?

"A. No, sir; as I said before, the gas enters the bottom of these large tanks, through openings sufficient to carry the capacity of the pipe lines, and that gas passes up through these tanks and out the top, and right back into the pipe line, without any interruption whatever." (II, R. 1484.)

The witness testified that the diameter of these tanks is about 30" and that they allow some expansion of the gas, but that this does not interrupt the forward movement of the gas. (II, R. 1484.)

The gas transported in Lines H and 2nd H is compressed at Petrolia, Texas; and the same is true of part of the gas coming into Texas through Line G; it goes through the compressor station at Gainesville. The compressing of the gas does not interrupt its

forward movement. The purpose is to aid and increase the movement. The gas comes into the compressor plant with the pressure varying from 100 to 250 pounds and leaves the plant with the pressure increased to around 250 to 325 pounds. (II, R. 1478.)

A part, but not all, of the gas produced or purchased in Oklahoma and transported into Texas in Lines H and 2nd H is stored temporarily in the ground on what is referred to in the record as the Miller Lease, near Petrolia, Texas. (II, R. 1477-1482.) None of the Line G gas is thus stored.

The Court of Civil Appeals states in its opinion that, for the period 1929 to 1933, appellant obtained about 4 per cent of its total gas supply from Oklahoma, this, of course, excluding the Wheeler County gas. (V, R. 3337.) This is an erroneous statement. A computation based on appellant's Exhibit 44 will show that the average amount of gas produced or purchased in Oklahoma and transported to Texas was about 11 per cent of the total amount transported by appellant. (V, R., 3201-3205.) There is no evidence in the record disputing the correctness of the quantities shown in appellant's Exhibit 44.

The State court further found that "the gas reserves in Texas are more than sufficient to supply all Texas needs." (V, R. 3337.) If the Court intended to hold that the Oklahoma gas supply available to appellant was not necessary in order to take care of the demands for gas made on appellant in Texas, the finding is without support in the evidence, which shows that the Oklahoma gas and the facilities used to transport it to Texas were necessary in order for

appellant to be able to supply its Texas customers during period of peak demand. (III, R. 2043-2044.)

2. Statement of Facts Affecting the Issue of Confiscation and Related Issues.

We have heretofore summarized the findings of the commission and stated the manner in which they were arrived at. (*Supra*, pp. 7-10.)

Appellant's Evidence.

At the trial appellees, to make out their prima facie case, offered the commission's order, and rested. Appellant then presented a motion for a directed verdict, and this being overruled, proceeded to introduce evidence showing that the order of the commission, as made and sought to be applied, was confiscatory. Appellant first proceeded with evidence rebutting the commission's findings as they were made; that is, with evidence showing the value of the entire "integrated operating system" that had been valued by the commission.

Appellant's evidence relating to a proper annual accrual to the reserve for depreciation, depletion and amortization and relating to operating revenues and expenses followed the same theory followed by the commission in its findings and was in direct rebuttal of the findings. The evidence that appellant thus introduced will be briefly stated.

On the issue as to a proper *rate base*, appellant introduced in evidence an appraisal showing the cost of reproducing its "integrated operating system" as of January 1, 1933. This appraisal was prepared in great detail and consisted of eight volumes, only the summaries of which have been included in

the printed record by appellant. (Appellant's Ex. 28, IV, R. 2363.) It showed $73,983,405.57 as the cost of reproducing the "integrated operating system." The commission's valuation of appellant's "integrated operating system" amounted to $46,246,617.53 (*supra*, p. 9.) Appellant's appraisal was prepared by Biddison, Connor and Steinberger. No question of their qualifications has been raised in this case. They were men thoroughly trained and experienced in their professions. (Biddison's qualifications, I, R. 609-613; Connor's qualifications, II, R. 858-869; Steinberger's qualifications, I, R. 475-481).

The property is well designed, maintained and operated. "It is an excellent property from all viewpoints." (I, R. 656.) The unit costs used in the appraisal were based, to a large extent, upon the experience of appellant in actual construction cost. These costs were determined by an analysis of construction records. (I, R. 638-639.) Labor rates were those currently prevailing (I, R. [illegible]) and the material prices used were the lowest quoted by leading manufacturers for large lot purchases. (I, R. 640-641; II, R. 842-843.)

The method employed in arriving at the reproduction cost new of physical properties was thoroughly explained by the witness Biddison. (I, R. 613-841; II, R. 1141-1226; III, R. 2002-2029.) The manner in which the witness Connor arrived at the collateral construction costs and non-physical values included in the appraisal was fully explained. (II, R. 869, et seq.; Appellant's Ex. 28, IV, R. 2602-3007.)

Gas reserves were determined by appellant's reg-

ularly employed production engineer and geologist. The manner in which the reserves were calculated was carefully explained by the witness Dunn (I, R. 512-544) and the results are shown in exhibit form. (Appellant's Ex. 30, V, R. 3007-3030.) Only proven and developed reserves were included in the appraisal. (I, R. 528, 529.) Those included represented only about one-third of the total gas acreage held by appellant. (I, R. 530.) It was estimated that appellant's gas reserves would be sufficient for approximately twenty years. (I, R. 531.) The value of the reserves included in the appraisal is set forth in exhibit form. (Appellant's Ex. 31, V, R. 3031-3033.)

Accrued depreciation was determined by inspection of the physical property. Fair value was determined by deducting the accrued depreciation thus determined from the reproduction cost new. (II, R. 1141-1171.) In this manner the *fair value* was determined to be $69,738,021.16. (Appellant's Ex. 37, V, R. 3037.) The appraisal was later supplemented to May 1, 1934. (Appellant's Ex. 40, V, R. 3047.) This supplemental appraisal showed an increase in material and construction costs between January 1, 1933, and May 1, 1934, of $1,579,381.72. (Appellant's Ex. 40, V, R. 3052.)

It was also shown that the difference between prices for steel pipe and dresser couplings adopted by the commission and those prevailing at June 11, 1934, amounted to an increase of $3,409,626.91, when applied to appellant's property. (Appellant's Ex. 39, V, R. 3043-3046.)

Costs of the property, as reflected by appellant's

books, were: December 31, 1931, $47,776,749.63, (Appellant's Ex. 5, III, R. 2209); December 31, 1932, $50,034,431.70, (Appellant's Ex. 6, III, R. 2212); December 31, 1933, $49,837,026.06, (Appellant's Ex. 8, III, R. 2215); April 30, 1934, $49,858,751.23 Appellant's Ex. 10, III, R. 2221). The decrease in costs, as reflected by the books, was due to property abandoned or taken out of the public service. The costs, as reflected by the books, did not include overhead construction costs incurred prior to 1927. It was not appellant's policy to capitalize these costs from 1909 to 1927, and a substantial part of the property was constructed prior to 1927. For other reasons explained in the record, the books understated the actual cost of the property. (I, R. 348-352.) The costs, as reflected by the books, did not include working capital, material and supplies, or going concern value. (I, R. 364-365.)

Annual accruals to reserve to provide for *depreciation, depletion and amortization* were estimated by appellant's witness Conner, at $3,465,123.36. This amounts to approximately 5% on the value as appraised by appellant ($3,465,123.36÷$69,738,021.16). The estimate was based on the straight line method of reserve accounting, the method actually used by appellant. (II, R. 1259-1260.) The commission used a sinking fund method. It allowed $968,066.98, or 2.28%, on the depreciable items of property, and approximately 2% on its total rate base, $46,246,617.53. (I, R. 98.) Connor treated this subject thoroughly both in exhibits and oral testimony. (II, R. 1256-1323.) Separate accrual rates for each of the various

classes of property were determined. (Appellant's Ex. 41, V, R. 3055.)

The basis upon which these accrual rates were determined is set forth in detail in exhibit form. (Appellant's Ex. 42, V, R. 3057-3196.) Briefly stated, the reserve accrual rates were based upon an analysis of the history of the various classes of property. The records examined covered a period from 1909 to 1933. (II, R. 1257; V, R. 3057-3060.) This study covered approximately 8,000,000 feet of three inch equivalent diameter pipe which had been removed, replaced and abandoned. (II, R. 1280-1284; V, R. 3073-3080.) All factors bearing upon the life of gas wells were analyzed. The history of over 1,000 gas wells which have been attached to appellant's system was included in this study. The average life of gas wells was thus determined to be four years. (II, R. 1268-1276.) This may be compared with the commission's finding of thirteen and one-half years. (II, R. 1275.) The dates upon which various lines in the system were put into service and the length of their service before replacements were required, were determined. (II, R. 1278-1288, 1295-1296.) All factors contributing to the mortality of the various classes of property were analyzed and given due weight in the ultimate conclusion.

The record shows that more than 60% of all the pipe in the system was installed new during the seven-year period prior to the date of inquiry. (V, R. 3081-3082.) Only 20.45% of the total compressor horse power in service at the date of inquiry had been installed prior to 1922. (V, R. 3175.) The pipe

lines and compressor equipment constitute the major portion of the total value ascribed to the physical property.

The annual rate of growth is shown in appellant's exhibit 42. (V, R. 3081.) The property had a weighted age of only twelve years at the date of inquiry. (III, R. 1860, 2041-2042.) Other facts establish that the system was a comparatively new one at the date of inquiry. Hence, the charges against reserve in past years were not deemed to represent the ultimate retirement liability which would accrue as the property grew older. Charges experienced in the past on the smaller property were no criterion for determining the reserve accruals needed to meet the increasing eventual retirement liability on the larger and newer system.

Operating expenses and revenues were shown in accounting exhibits covering the years 1931, 1932, 1933, and the twelve months ended April 30, 1934. Gross revenues and amounts available for depreciation, depletion and return under the 40¢ rate, after deduction of actual expenses of operation, were:

12 Mos. Ended	Gross Revenues	Amounts Available for Depreciation, Depletion and Return
12-31-31	$9,267,270.80	$4,605,721.83
12-31-32	8,831,205.35	4,658,506.46
12-31-33	7,690,167.01	3,892,748.58
4-30-34	7,923.087.30	4,114,322.81

(Ex. 5, III, R. 2209; Ex. 6, III. R. 2212; Ex. 8, III, R. 2215; Ex. 10, III, R. 2221.)

After allowing for depreciation reserve accruals in the sum estimated by appellant's witness, the sums

remaining would have provided the following amounts for return *under the 40¢ rate* on the fair value of the property as determined by appellant's witnesses: For the year 1931, 1.64%; 1932, 1.71%; 1933, .61% and the twelve months ended April 30, 1934, .93%.

All expenses of operation claimed by appellant were actually incurred in good faith by the management in the exercise of their best judgment. (I, R. 365.) They represent actual outlays. The accounts conform to the classification of accounts prescribed by the American Gas Association. (I, R. 315.) The Railroad Commission of Texas has not prescribed a classification of accounts. (I, R. 375-376.) There was no material dispute between the auditors for appellees and appellant with reference to actual revenues. Appellees' witness so testified. (III, R. 1661-1665.) The State court refers to this fact in its opinion. Said the court:

"With respect to operating expenses, except as to a few controverted items, and with respect to revenues, there is no substantial difference in the testimony as to the totals of both Texas and Oklahoma for the years of the accounting period." (V, R. 3364; 86 S. W. (2d) 503.)

Gross revenues and amounts available for depreciation, depletion, Federal income tax and return *under the 32¢ rate*, after adjusting operating expenses in accordance with the commission's findings, which eliminated management fees paid the holding company, and other items, were:

12 Mos. Ended	Gross Revenues	Amounts Available for Depreciation, Depletion, Federal Income Tax and Return
12-31-31	$7,941,986.82	$3,765,160.24
12-31-32	7,519,397.26	3,908,663.51
12-31-33	6,610,219.85	2,997,969.38
3-31-34	6,813,222.57	3,191,162.50

(III, R. 2270-2271.)

After allowing for depreciation reserve accruals in the sum estimated by appellant's witness, the sums remaining would have provided the following amounts for return *under the 32¢ rate* on the fair value of the property determined by appellant's witnesses:

12-31-31	.43%
12-31-32	.64%
12-31-33	.67% (deficit)
3-31-34	.39% (deficit)

Appellant's evidence also showed that after applying the 32¢ rate ordered by the commission, adjusting the operating expenses to conform to the commission's eliminations therefrom, computing depreciation and depletion reserve accruals as found by the commission, the amount available for return, when expressed as a percentage of the rate base adopted *by the commission* were as follows: For the year 1931, 5.56%; 1932, 5.76%; 1933, 3.97%; and twelve months ended March 31, 1934, 4.31%. Thus it appears that, considered in the light of the commission's own findings, the prescribed rate yields less than the "minimum fair return" as found by the commission—6 per cent. (*supra*, p. 10.) (Appel-

lant's Ex. 13, Sec. 3, III, R. 2233; for details, III, R. 2268, et seq.)

Upon the same basis, except that operating expenses were those actually incurred, it was determined that the prescribed rate would have allowed 3.76% for return on the commission's rate base, for the twelve months ended April 30, 1934. (Appellant's Ex. 14, III, R. 2304, et seq.)

Appellant's evidence showed that a net return of from 8% to 10% was reasonable; that such a return was necessary, considering the hazards of the business, in order for appellant to attract a free flow of capital into its business, insure confidence in the financial soundness thereof, support and maintain its credit, and properly discharge its public service obligations. The commission had never before allowed less than 7% for return to a natural gas utility. (II, R. 1329.) The testimony to this effect was given by appellant's engineers Biddison and Connor and two independent bankers, presidents of two of the larger banking institutions in Texas. These witnesses were familiar with the rates of return commonly demanded and received by investors in the securities of natural gas enterprises. (Connor, II, R. 1324-1330; Biddison, III, R. 2014; Thornton, III, R. 1960-1965; Florence, III, R. 1965-1977.)

(b) Appellant's evidence above summarized was in direct rebuttal of the commission's findings. Appelles objected to the admissibility of this evidence on the ground that it dealt with over-all properties and business operations—the same properties and operations covered by the commission's findings—

and was not based upon segregation of appellant's properties and operations as between interstate and intrastate commerce or as between Oklahoma and Texas. These objections, many times urged, were consistently overruled in the trial court and the evidence admitted.

Appellant, after offering the evidence we have summarized above, then offered additional evidence based upon a segregation of its "integrated operating system" as between interstate and intrastate commerce.

This segregation was based upon the actual use of appellant's properties in the two classes of commerce—upon the actual conduct of its business. The method employed is explained in appellant's Exhibit 45 (V, R. 3207, et seq.) It was also explained in detail by the witness Schmidt. (II, R. 1497-1529.) The basis used in segregating and allocating operating expenses and revenues is explained in appellant's Exhibit 46 (V, R. 3279, et seq.), and also in the oral testimony of the witness Hulcy (II-III, R. 1529-1604). On the basis of this segregation and allocation it was shown that the rate prescribed in the order, when applied to appellant's intrastate deliveries of gas, would yield 6.65% for depreciation and return for the year 1933 on the actual cost (Appellant's Ex. 46, V, R. 3283-3284), and 5.78% on the present value of the property employed in the intrastate public service. (V, R. 3287-3288.) After calculating reserve accruals for depreciation, depletion and amortization at the two per cent rate allowed by the commission, there remained available for return 4.65% on the actual cost, and 3.78% on the fair

value of the intrastate property. (II, R. 1563.) Of the total actual cost of the integrated operating system $32,080,146.32 was allocated to intrastate operations. (V, R. 3284, 3313, "D" Operations, Appellant's Ex. 46.) The fair value of the intrastate property was determined by segregating the appraised value shown in appellant's Exhibits 28 and 37 for the integrated system exclusive of going concern value. The fair value thus determined was $38,350,882.32. (V, R. 3288, 3314, "D" Operations, Appellant's Ex. 46.)

The only criticism made by the State court with respect to appellant's segregation between interstate and intrastate commerce was that Line A, used in transporting gas from Wheeler County, Texas, through Oklahoma and thence into Texas, had been allocated to interstate operations. (V, R. 3361.)

Appellant's evidence above summarized was rejected by the Court of Civil Appeals as not being material to any issue in the case; the evidence covering the entire "integrated operating system" upon the ground that it did not involve any segregation of properties and operations; and the evidence, based upon the segregation mentioned, upon the ground that the segregation, in the view of the State court, was an improper one, it being based upon the assumption that the Wheeler County gas was interstate gas. (V, R. 3361, 3362, 3364.)

Appellees' evidence on the confiscation issue.

Appellees offered no evidence supporting the commission's findings upon which it based its order;

they offered no evidence relating to appellant's "integrated operating system." They offered no evidence controverting the evidence introduced by appellant either with respect to the "integrated operating system" or with respect to appellant's segregation of its properties and operations between interstate and intrastate commerce. Instead of attempting to support the commission's findings and to rebut the evidence offered by the appellant, appellees offered evidence based upon a wholly different segregation of the properties and operations. Their evidence was based upon a segregation which, in the main, as pointed out by the State court, divided the property according to its geographical location and made a similar segregation of the operations. (V, R: 3360.)*

This evidence related to properties and operations that were never separately considered by the commission, as appears from its findings; the findings relate only to the integrated properties and operations. (I, R. 14-16.)

Upon the basis of Appellee's segregation, the State court found that "85 per cent of appellant's

*The Court will note that the State court in this connection refers to "the method of segregation adopted by the *commission*. (V, R. 3360.) This is a misleading and erroneous statement. As we have before pointed out, the commission as an administrative or legislative body made no segregation of the properties and operations in fixing the rate. On the contrary, it expressly found that the properties should be appraised and the operations considered as a "unit"; as an "integrated operating system." *(Supra,* p. 8.) This statement of the State court is correct only when applied to the commission as a *litigant;* certain witnesses testifying for the commission at the trial made the segregation to which the State court refers.

property is situated in Texas; and approximately 99 per cent of its gas reserves are in Texas." (V, R. 3337.)

Appellees' allocation referred to allocated to Oklahoma, or to "interstate commerce" (using their terminology) the properties physically located in that state and the operating revenues and expenses which they deemed to be properly allocable to such properties. They allocated to Texas, or to "intrastate operations," properties physically located in Texas and the revenues and expenses deemed to be allocable thereto. This segregation was based, not upon the actual use of the properties and the conduct of appellant's business operations, but upon a geographical standard unrelated to the actual use of the properties and conduct of the business. (III, R. 1668-1670.)

Appellees excluded from their appraisal of the Texas properties all of the production system property located in Texas and also the expenses incurred in the operation of such properties. (III, R. 1795-1796, 1903-1905.) This property was used and useful in appellant's public service. (III, R. 2044-2045.)

Appellees found a reproduction cost new for appellant's Texas gathering, transmission, compressing and general property of only $40,256,862.39 as of June 15, 1934. (Appellees' Ex. 6, III, R. 2141, et seq.) This figure includes nothing for going concern value. (III, R. 1793-1794; 2108.) The Texas properties thus segregated by appellees had a book cost of $44,053,612.30 as of March 31, 1934. This figure includes the production system properties in Texas, which were eliminated from appellee's appraisal. It

includes net capital additions to Texas properties at actual cost from January 1, 1932, to March 31, 1934, in the sum of $1,500,843.28. (Appellees' Ex. 4, III, R. 2125.) This book cost figure did not include cash working capital, materials and supplies, or going concern value.

Appellees' evidence showed $2,721,854.13 for the year 1933, and $2,714,877.13 for the twelve months ended March 31, 1934, available for return, after application of the 32 cent rate prescribed in the commission's order. This amounted to 6.76% for the former period and 6.74% for the latter period on the value of the Texas properties, as appraised by appellees in the amount and manner hitherto stated. (Appellant's Ex. 8, III, R. 2164.) The amount thus determined to be available for return was arrived at after eliminating all expenses incurred by appellant in the operation of its production system properties and after making an arbitrary addition to actual revenues of $441,240.12 for the year 1933, and $268,829.64 for the twelve months ended March 31, 1934. These additions to revenues were based on the theory that the year 1933 and the twelve months ended March 31, 1934, were abnormally warm periods. They represent appellees' calculation of the additional amount that appellant would have received under the 32 cent rate if the weather had been colder and more gas had been sold. (Appellees' Ex. 8, III, R. 2164-2165.)

Appellees estimated annual reserve accruals to provide for depreciation at $848,546.48. (Appellees' Ex. 7, III, R. 2159, 1843.) This amounted to 2.11% on the value of the Texas property as appraised by

appellees in their Exhibit 6. *(III,* R. 2142-2143.) This estimate was based on the sinking fund method. Appellees' witness testified that if he had used the straigth line method in computing depreciation reserve accruals he would have used the percentage of 4.205 on the physical properties, including the production system properties. He also testified that on the straight line basis he would have used a percentage of 3.0902 on both the physical and non-physical properties. (III, R. 1873-1874.) This would have amounted to approximately $1,404,355.61 upon appellees' valuation of the physical properties in Texas, plus the production system properties at cost. ($40,256,862.39+$5,191,539.42=$45,448,401.81× 3.09%=$1,404,355.61.) Appellees' expert admitted that his estimate would be insufficient to meet the calculated future mortalities unless supplemented by the existence and use of a credit balance in the reserve account at the date of inquiry of $5,000,000.00 for the transmission line equipment alone. It was assumed that this credit balance, together with future accumulations, would be further supplemented by interest at the rate of 6% per annum compounded. (III, R. 1860-1862.) Nothing was included in the estimate for depletion of gas reserves for depreciation on the production system properties. Appellees' expert conceded that at least $94,000.00 would be required for these purposes on the Texas properties. (III, R. 1912-1913.)

The effect of appellees' elimination of appellant's production system properties and expenses and their failure to provide for depletion and return thereon, is thus shown: The commission included in its rate

base $4,674,285.91 for appellant's production system properties. (I, R. 100.) All of these properties were eliminated by appellees. The commission made an allowance for expenses in operating the production system property of $247,732.86 for the year 1931, this being the year upon which the commission made its determination. (I, R. 21, 104.) The commission included approximately $116,000.00 for depreciation and depletion of the production system properties. (III, R. 1912.) The commission determined that it would require $636,533.46 to provide for operating expenses, depreciation, depletion, and a 6% return on the value included by it in the rate base for production system properties. (I, R. 104.) Appellees allowed only $212,031.46 for the year 1933, and $232,644.75 for the twelve months ended March 31, 1934, for the same purpose. (III, R. 2164.) The evidence shows that only approximately 1% of the production system properties are located in Oklahoma. (I, R. 459.)

Appellees' own accounting exhibit shows that the production system expenses amounted to $232,758.70 for the year 1933, and $222,752.66 for the twelve months ended March 31, 1934. (Appellees' Ex. 4, III, R. 2116-A.) These amounts represent expenses actually incurred by appellant.

The production system properties located in Texas, and eliminated by appellees, had an actual cost of $5,191,539.42 at March 31, 1934. (Appellees' Ex. 4, III, R. 2125.) They consisted of leases, mineral rights, gas rights, lands in fee, drilling tools, gas farms, gathering system, and Petrolia field property. The Petrolia Field property is included at

actual cost in the amount of $758,619.23. (Appellees' Ex. 4, III, R. 2125.) Instead of including the production system properties in the appraisal and allowing operating expenses, depletion and return thereon, appellees substituted an arbitrary allowance in lieu thereof. The allowance substituted by appellees amount to $212,031.46 for the year ended December 31, 1933, and $232,644.75 for the twelve months ended March 31, 1934. (Appellees' Ex. 8, III, R. 2164.) These substituted amounts were arrived at by applying to the volume of gas produced by appellant from its own wells in Texas the average prevailing well head price in the field. (III, R. 1903.) The deficiency of appellees' allowance for the year 1933 alone is thus shown:

The operating expenses on the production system properties for the year 1933 were $232,758.70 as heretofore shown. $94,000.00 would be required for depletion, according to appellees' expert witness. A 6% return on the actual cost of the production system properties would be $311,492.36. This makes a total requirement for operating expense, depletion and return of $638,251.06. This sum is to be compared with appellees' allowance of only $212,031.46. The allowance is therefore deficient by $426,219.60.

The foregoing statement is regarded as being sufficient to show, not only the facts affecting confiscation on the merits, but also the facts affecting the various rulings made by the State court in connection with appellant's alleged failure to make a proper segregation of its integrated properties and operations. For that reason a separate statement on the issues mentioned will not be submitted.

3. Statement of the Facts Affecting Appellant's Claim That It Was Denied an Adequate Judicial Review of the Order.

That the evidence was at least sufficient to raise an issue of fact as to whether the rate was confiscatory is shown by the statement previously submitted, *supra*, pp. 34-50. The Court of Civil Appeals held that in respect to certain vital matters affecting the issue of confiscation, including the issue as to the *fair value* of appellant's properties and the issue as to what would be a *fair rate of return*, the evidence was conflicting and at most "merely presented the difference of opinions of equally well qualified experts." (V, R. 3363, 3368.) The court further held that, in these circumstances, the jury had no right to resolve the conflict in the evidence and that appellant's attack on the rate order should be overruled as a matter of law. Appellant has challenged this ruling as involving a denial of adequate judicial review of the rate order.

It has been found more convenient to state the facts and the various rulings of the Court of Civil Appeals affecting this issue of adequate judicial review as a part of the argument hereinafter presented, *infra*, pp. 124-134. For that reason no separate statement is here submitted.

V.

Specification of Errors Intended to Be Urged.

Appellant assigns the following errors committed by the Court of Civil Appeals in entering its judg-

ment, affirming and sustaining the validity of said rate order, as against appellant's attack thereon based on the Commerce Clause of the Federal Constitution and the Due Process Clause of the Fourteenth Amendment to the Federal Constitution; and it shows that in making each of the rulings complained of in Sections I to VI of this Assignment of Errors the Court of Civil Appeals denied to appellant rights secured to it by the Commerce Clause of the Federal Constitution; and that each of the rulings complained of in Sections VII to XV of this Assignment of Errors deprives appellant of its property without due process of law in violation of the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States.

1. The Court of Civil Appeals erred in holding that appellant pipe line company was not engaged in interstate commerce in transporting and selling gas produced or purchased by it in Wheeler County, Texas, and transported in its high pressure line through Oklahoma and thence back into the State of Texas to the city gates in Texas where delivery is made to local distributing companies.

2. The Court of Civil Appeals erred in holding that the rate order did not interfere with and constitute a direct burden upon interstate commerce and appellant's right to engage therein, in violation of Article I, Section 8, Paragraph 3 of the Constitution of the United States, and was not void and unenforceable in so far as it was sought to be enforced as to gas produced or purchased in Wheeler County,

Texas, transported in appellant's high pressure pipe line A through Oklahoma and ultimately delivered in wholesale quantities at city gates in Texas.

3. The Court of Civil Appeals erred in holding that the gas produced or purchased by appellant in Oklahoma and transported by its pipe lines to Texas does not move in interstate commerce when it reaches the Texas city gates for delivery.

4. The Court of Civil Appeals erred in holding that the rate order did not interfere with an constitute a direct burden upon interstate commerce and appellant's right to engage therein, in violation of Article I, Section 8, Paragraph 3 of the Constitution of the United States, and was not void and unenforceable in so far as it was sought to be enforced as to gas purchased and produced in Oklahoma, transported in appellant's high pressure pipe lines from Oklahoma and ultimately delivered in wholesale quantities at city gates in Texas.

5. The Court of Civil Appeals erred in upholding the rate order in question as against appellant's attack thereon grounded upon the claim that it operated as a direct regulation of interstate commerce, in which appellant was engaged, in violation of the Commerce Clause of the Constitution of the United States.

6. The Court of Civil Appeals erred in failing to hold that the order of the Railroad Commission was void and the rate therein prescribed unenforceable as

to all gas sold by appellant pipe line company in Texas inasmuch as the same was void and unenforceable in part (as to gas sold and delivered in interstate commerce) and inasmuch as the same was indivisible.

7. The Court of Civil Appeals having held that the courts of this State, in this suit involving the validity of the rate order in question, challenged as being confiscatory and for that reason violative of the Due Process Clause of the Fourteenth Amendment, are without power to weigh the evidence and settle the conflicts in the evidence and pass their independent judgment on the facts as well as the law, relating to the tendered issue of confiscation, erred in holding that the rate order was valid. This ruling of the Court denied to appellant that adequate judicial review granted to it by the Due Process Clause of the Fourteenth Amendment to the Federal Constitution, and the enforcement of the rate order against appellant under such circumstances will deprive it of its property without due process of law, in violation of the Fourteenth Amendment to the Federal Constitution.

8. The Court of Civil Appeals erred in refusing to consider, and in holding to be immaterial, appellant's evidence as to the value of its integrated pipe line properties, located both in Texas and in Oklahoma, and its revenues and expenses incident to the operation of such properties, appellant thereby being deprived of its right to attack the rate and the findings of the Commission upon which it was based on

the same theory and by the same character of evidence underlying the promulgation of the rate, and thus being denied an adequate judicial review of the rate order and deprived of due process of law, contrary to the provisions of the Fourteenth Amendment to the Constitution of the United States.

9. The Commission, having found that appellant's property and business was an integrated system and having valued the same as such and the Court of Civil Appeals having found that appellant was not engaged in interstate commerce in transporting and supplying gas at the city gates of cities and towns in Texas, and appellant having introduced evidence showing that the order of the Commission would not permit it to receive in any of the years involved as much as a six per cent (6%) return on the fair value of its integrated public service properties, the Court of Civil Appeals erred in holding that the evidence was insufficient as a matter of law to raise an issue of fact as to the confiscatory character of the rate.

10. The Court of Civil Appeals, having held that appellant is not engaged in interstate commerce in the transportation and delivery of gas at the city gates in Texas, erred in holding that it was necessary to segregate appellant's integrated pipe line property and business as between interstate and intrastate commerce in order to test the validity of the rate.

11. The Court of Civil Appeals erred in holding that appellant failed to make a proper segregation

of its properties and operations as between interstate and intrastate commerce.

12. The Court of Civil Appeals erred in holding that the evidence introduced by appellant based upon a segregation of its properties and operations as between interstate and intrastate commerce proved nothing material to the case.

13. The Court of Civil Appeals erred in holding that, since appellant failed to make a proper segregation of its properties as between interstate and intrastate commerce, it did not adduce the quantum and character of proof necessary to establish the invalidity of the rate as being confiscatory.

14. The Court of Civil Appeals erred in approving a segregation of appellant's properties and operations as between interstate and intrastate commerce that was based merely on geographical location of the property and not upon the way in which the property was used and the business conducted.

15. The Court of Civil Appeals erred in upholding the validity of the rate order as against appellant's claim that same was confiscatory in its operation and was violative of appellant's rights under the Due Process Clause of the Fourteenth Amendment to the Constitution of the United States in the following particulars, and in each of said particulars appellant was deprived of its property without due process of law, in violation of the Fourteenth Amendment to the Constitution of the United States:

(a) In adopting a rate base of $40,256,862.39 which did not include the value of appellant's production system property consisting of natural gas reserves, both producing and non-producing, gas wells, gas well equipment, drilling tools and equipment used and useful in the public service in Texas, all of such property costing approximately $5,200,000.00.

(b) In approving the elimination of all operating expenses actually incurred in good faith in the operation of appellant's production system property amounting to the sum of $232,759.70 for 1933, and $222,752.66 for the twelve months period ended March 31, 1934.

(c) In adopting appellees' estimate of $831,946.08 per annum for depreciation, depletion and amortization reserve accruals, which did not embrace any sum for depreciation, depletion or amortization on appellant's production system property, gas wells, gas well equipment, drilling tools and equipment used and useful in the Texas public service.

(d) In adopting a formula in lieu of actual operating expenses and an allowance for annual accruals to reserve for depreciation, depletion and amortization and a fair return on appellant's gas reserves, gas wells, gas well equipment and other production system property, consisting of an addition to operating expenses of a sum of money arrived at by applying the average well head price paid by appellant to independent producers to the volume of gas pro-

duced by appellant from its own Texas gas reserves, such substituted sum being insufficient by approximately $426,000.00 to provide for operating expenses, the necessary annual reserve accrual for depreciation, depletion and amortization (as estimated by appellees' witnesses) and a 6% return (which the Commission held was the minimum to which appellant was entitled) on the actual cost of such property.

(e) In adopting a rate base of $40,256,867.39, which did not include the value of appellant's property located in Oklahoma actually and necessarily used and useful in transporting to Texas for sale and delivery therein gas purchased and produced in Oklahoma.

(f) In approving the elimination from operating expenses of all expenses actually and in good faith incurred in the operation of appellant's properties located in Oklahoma, actually and necessarily used and useful in transporting to Texas for sale and delivery therein, gas purchased and produced in Oklahoma and the disallowance of any depletion or amortization of such properties.

(g) In adopting an arbitrary addition to appellant's actual revenues of $441,240.12 for the year 1933, and $268,829.64 for the twelve months ended March 31, 1934, to compensate for assumed deficiencies in actual gas sales due to abnormally warm weather.

(h) In adopting an annual allowance for depreciation, depletion and amortization reserve accruals of $831,946.08, which amount was insufficient for current and future requirements without being supplemented by an assumed credit balance in the reserve account of $5,000,000 at the date of inquiry.

(i) In adopting a rate base containing no allowance to cover the item of going concern value.

(j) In failing to hold that a six per cent return was confiscatory.

(k) In approving a rate which would not permit appellant to earn the six per cent return which the Railroad Commission held was the minimum to which it was entitled on the fair value of its Texas public service properties as determined by appellees' witnesses upon the trial if appellant's production system property be included in said evaluation and actual operating expenses and revenues be allowed, and if effect be given to a 2% per annum reserve accrual for depreciation, depletion and amortization allowed by the Commission.

(l) In approving a rate which appellant's unrebutted evidence showed would not permit it to earn the minimum 6% return, to which the Commission held it was entitled, upon the fair value of its integrated properties as determined by the Commission after computing accruals to the reserve for depreciation, depletion and amortization at the rate approved by the Commission.

(m) In approving a rate which appellant's uncontradicted evidence clearly showed would not permit it to earn in excess of 3.78% on its fair value, and 4.65% on the actual cost of its properties used and useful in intrastate commerce in Texas as determined by appellant's segregation between interstate and intrastate commerce, based upon use, after allowing for annual accruals to the reserve for depreciation, depletion and amortization at the rate of 2%, being the rate adopted by the Commission.

(n) In holding immaterial and refusing to consider or permit the trial court to consider appellant's evidence showing that the depreciated fair value of its integrated properties was $69,738,021.16, whereas the Commission found the undepreciated value of such property to be $46,246,617.53.

(o) In holding that appellant's evidence showing that a fair annual allowance for accruals to the depreciation, depletion and amortization reserve was not less than $3,465,123.36, as compared with the Commission's allowance of only $983,697.98, for its entire integrated property and business, was of no probative force. (V, R. 3461-3467.)

VI.

Summary of Argument.

I. The Wheeler County gas transported through Oklahoma for sale and delivery at city gates in Texas, constitutes interstate commerce. The rate

order, as applied to it, is void under the Commerce Clause.

1. The interstate character of the movement of this gas is fixed by the fact that it is transported through another State.
2. Appellant's motives in constructing its Line A through Oklahoma are not material.
3. The commingling of a part of this gas is without effect on the interstate commerce issue.
4. Appellant's interstate business may not be subjected to direct regulation on the ground that it is small as compared with its intrastate business.
5. The State court's holding that the rate may be applied to interstate deliveries, provided it is reasonable, is plainly wrong.
6. Discussion of the failure of the Congress to regulate gas pipe lines.
7. Corporate affiliation between appellant and the distributing companies is not material to the correct determination of the interstate commerce issue.
8. The rate order is an indivisible legislative act and, being void as to the interstate deliveries, it is also void as to the intrastate deliveries.

II. The transportation, sale and delivery in Texas of the gas, produced or purchased in Oklahoma, con-

stitutes interstate commerce, and the rate order, as applied to this gas, violates the Commerce Clause.

III. The State court's holding that appellant's evidence, relating to the value of the entire "integrated operating system" and the revenues accruing therefrom and operating expenses incurred in connection therewith, was not material and should not be considered because of appellant's failure to make a proper segregation of its properties and operations, as between interstate and intrastate commerce or between Oklahoma and Texas, is plainly wrong.

1. The ruling of the State court in this connection denied appellant a fair opportunity to prove that the rate order was confiscatory and amounted to a denial of due process.
2. If any segregation was necessary, then a proper basis therefor was laid in the evidence and, presumptively, the jury, following the charge, made the segregation.

IV. The holding of the State court that the triers of fact were without power to settle conflicts in the evidence denied appellant an adequate judicial review of the rate order on the tendered issue of confiscation.

V. The finding of the jury that the rate was confiscatory is sustained by clear and satisfactory evidence. Therefore the judgment of the Court of Civil Appeals should be reversed and that of the District Court affirmed.

1. Discussion of various items criticized by the Court of Civil Appeals.
2. Discussion of actual application of the rate order under various bases of fact supported by the record.

ARGUMENT.

Point One.

The transportation of the Wheeler County gas from Wheeler County, Texas, through Oklahoma and back into Texas, for sale and delivery at city gates in Texas, constitutes interstate commerce, and the rate order fixing the price or rate that appellant may collect upon sale and delivery of this gas at city gates in Texas is unconstitutional and void, because amounting to a direct regulation of interstate commerce.

The facts relating to appellant's high pressure gas pipe line, designated as Line A, and the Wheeler County gas transported in it from the great Panhandle gas field in Wheeler County, Texas, through Oklahoma and back into Texas, for sale and delivery in wholesale quantities at city gates in Oklahoma and Texas, have been stated, *supra*, pp. 22-30. These facts are undisputed; the question arising thereon is simply one of law.

The gas is taken from the wells in Wheeler County, Texas, at high pressure and is transported, without interruption of movement, under the original rock pressure, through Line A and the branch line just mentioned to the city gate delivery points; part of it to city gates in Oklahoma and the remainder to

city gates in Texas. The pressures in the transportation line vary from 300 to 450 pounds. At the city gate delivery points the pressure is reduced to 25 or 30 pounds. This is done solely for the purpose of making the delivery and as a part of the delivery; *supra*, p. 25. The pressures are reduced to a point where the gas may be safely transported through the lines of the distributing company. (*Supra*, p. 25.) The reduction in pressure is accomplished by the use of regulators. These, under the contracts, are installed, maintained and operated by the distributing company. (IV, R. 2308.)

The transporting, selling and delivering of this Wheeler County gas at city gates in Texas and Oklahoma, in the manner shown by the undisputed evidence, constitutes interstate commerce, and the State commission was without authority to regulate this commerce in the way attempted. The case is clearly ruled by *Hanley vs. Kansas City Southern Ry. Co., 187 U. S. 617*, considered in connection with

Missouri vs. Kansas Nautral Gas Co., 265 U. S. 298;

Public Utilities Comm. vs. Attleboro Co., 273 U. S. 83, 90;

Peoples Gas Co. vs. Public Service Comm., 270 U. S. 550, 554;

State Tax Comm. vs. Interstate Natural Gas Co., 284 U. S. 41;

State Corporation Comm. vs. Wichita Gas Co., 290 U. S. 561, 563, 564.

Orderly presentation requires that the various reasons assigned by the State court in support of its ruling be separately discussed.

1. The interstate character of the movement of this Wheeler County gas is fixed by the fact that it is transported through Oklahoma.

The interstate character of the transportation, sale and delivery of this gas is in no way affected by the fact that the point of origin and points of termini where the city gate deliveries are made in Texas are located in the same State—Texas. The holding of the State court on this point is in direct conflict with the holding of this Court in *Hanley vs. Kansas City Southern Railway Co., 187 U. S. 617*, and the following later cases:

Western Union Tel. Co. vs. Speight, 254 U. S. 17;
Missouri Pacific R. Co. vs. Stroud, 267 U. S. 404;
State Tax Comm. vs. Interstate Natural Gas Co., 284 U. S. 41.

The State court in its opinion held that the transportation of this Wheeler County gas across the State of Oklahoma for sale and delivery at city gates in Texas "is not interstate commerce as a matter of fact." (V, R. 3346.)

In this connection the State court further said that:

"The mere fact that appellee has selected a route through Oklahoma as an aid to the transaction of its Texas business cannot work a change in the nature of the business, nor does it affect the character of the business. The transportation of gas through Oklahome is merely a method of delivery and is a negligible circumstance in determining the interstate commerce issue. (V, R. 3347.)

The holding of the State court that the transporting of this gas from one point in Texas to other points in Texas, through the State of Oklahoma, is not "*interstate commerce as a matter of fact*" is in clear conflict with the decision of this Court in *Western Union Tel. Co. vs. Speight, 254 U. S. 17.* That case involved the question whether the sending of a telegraph message from one point in North Carolina to another point in North Carolina, but transmitted through the State of Virginia, was interstate commerce. This Court, in an opinion by Mr. Justice Holmes, held that the transaction constituted "interstate commerce *as a matter of fact.*" (254 U. S. 18; our italics.) And in the same case the Court further said:

"The fact must be tested by the actual transaction."

The Court in *Hanley vs. Kansas City Southern Ry. Co., supra,* approved the following test laid down by Mr. Justice Field sitting on the Circuit:

" 'To bring the transportation within the control of the State, as part of its domestic commerce, the subject transported must be within the entire voyage under the exclusive jurisdiction of the State.' " (187 U. S. 620.)

Part of this Wheeler County gas transported through Line A is sold and delivered by appellant to a distributing company at Hollis, Oklahoma. (V, R. 3346.) Part of it after reaching Texas is transported, without interruption of movement, back into Oklahoma in appellant's branch line extending from

Oklaunion, Texas, northward into Oklahoma. The gas last referred to is delivered by appellant at city gates to distributing companies supplying the following Oklahoma cities: Davidson, Manitou, Frederick, Tipton, Snyder and Mountain Park.* *(Supra,* p. 23.)

We assume that it will not be seriously contended that these Oklahoma city gate deliveries, made at the various cities, located on the branch line extending northward from Oklaunion, Texas, constitute intrastate commerce carried on in the State of Oklahome. Such a contention would be in plain conflict with the holding of this Court in *Missouri vs. Kansas Natural Gas Co., 265 U. S. 298*, approved and followed in later cases. Clearly the power to regulate the rate applicable to these Oklahoma deliveries is exclusively vested in Congress.

Missouri vs. Kansas Natural Gas Co., supra;
Public Utilities Comm. vs. Attleboro Co., 273 U. S. 83;
Peoples Natural Gas Co. vs. Public Service Comm., 270 U. S. 550;
State Corporation Comm. vs. Wichita Gas Co., 290 U. S. 561, 563, 564;
East Ohio Gas Co. vs. Tax Commission of Ohio, 283 U. S. 465.

If Oklahoma has not the authority to regulate the rates applicable to the Oklahoma deliveries made on

*The Court of Civil Appeals states in its opinion that this Wheeler County gas is delivered to only one Oklahoma city, Hollis. (V, R. 3346.) The statement is erroneous because it ignores the Oklahoma cities on the branch line extending from Texas into Oklahoma. (III, R. 1671-1673, 2063.) See map attached hereto.

this line, then Texas has not the authority to regulate the rates applicable to the deliveries made from that part of the line lying in Texas. In *Hanley vs. Kansas City Southern Ry. Co. supra*, this Court said:

"If one could not regulate it the other could not."

The Texas part of the line is being used in the same way as is the Oklahoma part of the line: A part of the gas moves without interruption to the city gates in Oklahoma and the remainder moves, in the same way, to city gates in Texas. All of it is being transported and delivered in interstate commerce. The power of regulating the rates applicable to deliveries made on this line may not be split up between the two States in proportion to the line mileage located in each State.

In *Hanley vs. Kansas City Southern Ry Co., supra*, the State attempted to regulate a rate covering a shipment from one point in Arkansas to another point in Arkansas, the railroad line extending, however, through the Indian Territory. This Court said:

"No one contends that the regulations could be split up according to the jurisdiction of State or Territory over the track, or that both State and Territory may regulate the whole rate, fixed by one authority, whether that authority be Arkansas or Congress." (187 U. S. 620.)

In the same case the Court said that "when a rate is established it must be established as a whole." (187 U. S. 621.)

If the Texas commission has authority to regulate the city gate rate for the deliveries made on Line A, it also has authority to fix the conditions governing the rendering of the service to which the rate is applicable. Let it be supposed that the Wheeler County supply should become inadequate to meet the full city gate demands of Oklahoma and Texas towns on this line; that, in time will inevitably be true. In that situation the prorating of the total supply will become necessary. We assume that it would hardly be contended that the power to prorate the supply as between the Oklahoma and Texas points of delivery would be vested in either the Texas commission or the Oklahoma commission. Undoubtedly, that power would be vested exclusively in Congress. And the same applies to rate regulation. It cannot be true that the power of rate regulation is vested in one authority and the power to regulate the rendering of the service is vested in another authority.

Lehigh Valley R. Co. vs. Pennsylvania, 145 U. S. 192, upon which appellees strongly relied in the State court, is distinguishable upon the grounds pointed out in *Hanley vs. Kansas City Southern Ry. Co., supra.* The case involved a taxing statute and the tax "was determined in respect of receipts for the proportion of the transportation within the State." (145 U. S. 201.) A tax thus proportioned had been previously sustained. *Maine vs. Grand Trunk Ry. Co., 142 U. S. 217.* The case merely holds that the State may require payment of an occupation tax from one engaged in both intrastate and interstate commerce, the tax being properly proportioned. See

Cooney vs. Mountain States Telephone Co., 294 U. S. 384, 392 (footnote).

All later decisions have confined the application of *Lehigh Valley R. Co. vs. Pennsylvania, supra,* to questions of taxation, as distinguished from questions of rate regulation.*

The rule laid down in the Hanley case, and followed in later cases, has been recognized and applied in many Federal statutes regulating interstate commerce. The Transportation Act of 1920 subjects to its provisions all transportation of passengers and property, except that taking place "wholly within one State." *Sec. 1, Subdivision (2) (a).* The National Labor Relations Act defines "commerce" as meaning trade, traffic or transportation among the several States or "between points in the same State but through any other State." *(Sec. 152, 49 Stat. 450.)* Section 2, Paragraph (3) of an act to regulater interstate and foreign commerce in petroleum and its products by prohibiting the shipment in such commerce of petroleum and its products in violation of State law, approved February 22, 1935, defines "interstate commerce" as meaning commerce between "points within the same State but through any place outside thereof." (49 Stat. 30.)

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*This has been recognized in the lower Federal Courts. See opinion of Judge Learned Hand in *United States vs. Yohn, 275 Fed. 232,* affirmed in *Yohn vs. United States, (C. C. A., 2), 280 Fed. 511,* and by many State courts: *Leibengood vs. Missouri, K. & T. Ry. Co., 88 Kan. 25; Hall vs. Pennsylvania R. Co., 257 Pa. 54.* The same distinction has been recognized by text writers: *Willoughby on the Constitution, (2 ed.), Vol. 2, p. 1002; Gavit, The Commerce Clause, p. 109.*

2. The motives moving appellant to construct Line A through Oklahoma are not material.

Appellees contend that the interstate commerce issue is not involved because appellant in locating and constructing Line A so as to extend through the State of Oklahoma was attempting, fraudulently, to evade the jurisdiction of the rate making authorities in Texas. The State court discussed this contention, without either sustaining or overruling the claim that appellant's motive in constructing Line A through Oklahoma would have controlling effect on the issue of interstate commerce. But it is clear that the State court was influenced by this plainly erroneous contention. The court stated in its opinion that the commission had alleged "and indisputably proved that this pipe line was built through a sparsely settled, rough, rocky region, just within and paralleling the boundary line of Oklahoma," and that its construction was more expensive than would have been its construction wholly within Texas. (V, R. 3337.)

The State court further held that the mere fact that appellant has selected a route through Oklahoma as an aid to the transaction of its Texas business could not change the nature or affect the character of that business. (V, R. 3347.) Said the court:

"Neither the Texas statute nor the rate order interfere in any manner with the transportation of gas from Texas through Oklahoma and back into Texas. The order only attempts to regulate and fix the price for which such gas may be sold in Texas by

appellee to its various distributing companies. Manifestly, this circuitous route of delivery of gas through Oklahoma cannot and does not affect the exercise of the police power of Texas to make or fix reasonable rates for such gas sold to its citizens." (V, R. 3347.)

It is not material to inquire whether it was necessary for appellant to construct this line through Oklahoma or to consider the reasons that moved appellant to so construct it. The character of appellant's business as being interstate commerce is determined by the actual manner of conducting the business, and not by appellant's motives in so conducting it. The business is not divested of its interstate character by showing that its owner deliberately chose to arrange it that way, whatever may have been the owner's motive. *Kirmeyer vs. Kansas, 236 U. S. 568, 572.* One may not be tried and convicted as for negligence or fraud, because of conducting his businses in such a way as that it constitutes interstate commerce.

Western Union Tel. Co. vs. Speight, 254 U. S. 17; Missouri Pacific R. Co. vs. Stroud, 267 U. S. 404; Kirmeyer vs. Kansas, 236 U. S. 568, 572.

In *Western Union Tel. Co. vs. Speight, supra,* it was contended that the sending of a message through the State of Virginia was unnecessary; that it was the duty of the company to confine its transmission to the State of North Carolina; and that the burden devolved upon the company to show that what was done "was not to evade the jurisdiction of the state."

This contention was upheld in the State court (178 N. C. 146). This court held that the character of the transaction as constituting intrastate or interstate commerce must be tested by the actual facts and that "the motive would not have made the business intrastate." (254 U. S. 19.)

To the same effect was the decision of this Court *In Missouri Pacific R. Co. vs. Stroud, 267 U. S. 404.*

Kirmeyer vs. Kansas, 236 U. S. 568, is directly applicable. In that case the State court found, and the finding was approved by this Court, that Kirmeyer adopted a cumbersome and expensive method of conducting a liquor business so that the business would constitute interstate commerce and for the sole purpose of avoiding the liquor laws of Kansas. Overruling the State court, this Court held that Kirmeyer's motives were not material; that whether his business constituted interstate commerce "must be tested by the actual transactions." Said the Court:

"Considered in the light of our former decisions, if the business carried on by plaintiff in error after removal of his office to Stillings had been conducted by a dealer who had always operated from that place we think there could be no serious doubt of its interstate character. And we cannot conclude that a legal domicile in Kansas coupled with a reprehensible past and a purpose to avoid the consequences of the statutes of the State suffice to change the nature of the transactions. Otherwise one of two persons located side by side in the same State and doing the same business in identical ways might be engaged in interstate commerce while the other was not." (236 U. S. 572-573.)

It is further submitted that appellees failed to establish their claim of improper motive in locating Line A through Oklahoma. The evidence shows that appellant's selection of this Oklahoma route was an engineering decision based upon a careful investigation of the relative merits of this and another route located wholly within the State of Texas. These reasons were fully and clearly detailed in the testimony of the witness Schmidt, who acted as appellant's engineer in locating the line. (II, R. 1487-8, 1489.) The locating engineer testified that the matter of constructing the line so that the deliveries made from it would constitute interstate commerce, not subject to State regulation, was never discussed or even mentioned in connection with the selection of the route. (II, R. 1474-5); and that the line "was constructed entirely on engineering principles and nothing else." (II, R. 1475.)

The evidence offered to show that the route was fraudulently selected, in an effort to evade State regulation of deliveries made from it, shows no more than the fact that some other route located wholly within the State might just as well have been selected.

3. The commingling of a part of the Wheeler County gas, after it passes Wichita Falls, Texas, with other gas, before delivery, is without effect on the interstate commerce issue.

A good deal is said in the opinion of the State court about the commingling of gas in appellant's lines. (V, R. 3336-3348.) No commingling of this Wheeler

County gas takes place until after it has passed Wichita Falls, Texas, going south. It furnishes the exclusive source of supply, in *uncommingled* state, for Wichita Falls and all of the Texas cities and towns located to the north and west on the line, as well as for Hollis, Oklahoma, and the Oklahoma cities located on the branch line extending north back into Oklahoma from Oklaunion, Texas. (*Supra*, p. 23.) The rate order as written, and as construed and enforced by the commission and the State court, is an indivisible act, of a legislative nature. (*Infra*, pp. 97-104.) It applies as well to the uncommingled deliveries at Wichita Falls and the other Texas cities just mentioned as it does to the commingled deliveries made after the gas passes Wichita Falls. Being clearly void as to the uncommingled deliveries made at Wichita Falls and the other Texas cities north and west of that place, and being indivisible, it is void as to all of the deliveries.

Furthermore, the commingling of a part of this Wheeler County gas, transported across Oklahoma, with intrastate gas after it passes Wichita Falls, Texas, going south, is not material because the total amount of this Wheeler County gas is definitely known—being 17 per cent of the total amount of gas sold and delivered by appellant at city gates in Texas, as found by the State court (*supra*, V, R. 3337.) Where the quantities commingled are known, the commingling does not mean that all of the gas becomes intrastate gas. The quantity of the interstate gas being known, its interstate character remains, notwithstanding the commingling.

Peoples Natural Gas Co. vs. Public Service Comm., 270 U. S. 550, 554, 555;
United Fuel Gas Co. vs. Hallanan, 257 U. S. 277, 281;
Board of Trade vs. Olsen, 262 U. S. 1, 38, 34.

Commingling or no commingling, the order is void in so far as it fixes the rate for the interstate deliveries, the quantities of which are known. And being indivisible, it is wholly void. (*Infra*, pp. 97-104.)

4. Appellant's interstate business may not be regulated by the State on the theory that it is small in amount as compared with its intrastate business.

That the amount of this Wheeler County gas (17% of the amount sold and delivered by appellant in Texas) may be less than the amount transported and sold in intrastate commerce is not material, for the amount is known and the prescribed rate falls on all gas sold in Texas, including this interstate gas. That appellant's intrastate deliveries exceed in amount its interstate deliveries does not confer power on the State commission to regulate the interstate deliveries as well as the intrastate deliveries in the way attempted.*

Inasmuch as the fixing of the rate imposes a direct burden upon interstate commerce "it is none the less beyond the power of the State because this may be a smaller part of the general business." *Public Utilities Comm. vs. Attleboro Co., 273 U. S. 83.*

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*To this Wheeler County gas delivered in Texas in interstate commerce should be added the Oklahoma gas, making a total amount of approximately 29% of appellant's total Texas deliveries.

A State statute that imposes a direct burden upon interstate commerce may not be sustained because the burden imposed is relatively small. *Cudahy Packing Co. vs. Hinkle, 278 U. S. 460, 466.*

"The action of the state, as a regulation of interstate commerce, does not depend upon the degree of interference; it is illegal in any degree." *Heisler vs. Thomas Colliery Co., 260 U. S. 245, 259.*

In Looney vs. Crane Co., 245 U. S. 178, 190, the Court said:

"It is thus manifest on the face of all the cases that they in no way sustain the assumption that because a violation of the Constitution was not a large one it would be sanctioned. * * * ".

If quantity or amount of burden were controlling, then the attempted direct regulation of 17% of appellant's deliveries of gas would be enough; less than 3% was involved in *Public Utilities Comm. vs. Attleboro Co., 273 U. S. 83, 91.*

People Natural Gas Co. vs. Public Service Comm., 270 U. S. 550, is distinguishable because there the challenged order, as construed by the State court, applied only to the intrastate part of the commingled mixture, leaving the gas company free "to deal in usual course with so much of the mixture as represents the gas from West Virginia"—the interstate gas. The order applied only to the City of Johnstown, Pennsylvania. It ordered the company not to discontinue the furnishing of gas to Johnstown. The company had on hand, as found by the State court, a sufficient amount of intrastate gas to perform the order and also had on hand enough interstate gas to serve the other cities on its line. This

Court held that, in these circumstances, "the order does not interfere with or affect the interstate commerce in which the company is engaged." In *Peoples Natural Gas Company vs. Public Service Commission, supra,* the order was separable on its face and as construed and sought to be enforced by the State commission and State courts. Here the challenged order, as construed by the State commission and State court, applies to all of appellant's deliveries in Texas, including any deliveries constituting interstate commerce. It is an indivisible order. (*Infra,* pp. 97-104.) The order amounts to an indiscriminate regulation of interstate and intrastate commerce. This being its character, the entire order must fall. *Illinois Central Ry. vs. McKendree, 203 U. S. 514, 529; Cooney vs. Mountain States Tel. Co., 294 U. S. 384, 392, 393.*

It is further submitted that, even if the quantity of this Wheeler County gas were not known, still the attempted regulation could not stand. It would be sufficient, in the circumstances mentioned, that the regulation applies to the Wheeler County gas and, thus applied, amounts to a direct regulation of interstate commerce. That fact would establish that the commission had gone beyond the limits of its rightful authority, and, the regulation being indivisible, the entire regulation must fall. Under the decisions of this Court the State may not to any extent directly regulate the interstate deliveries. The amount of the burden imposed by the regulation is immaterial. It is sufficient that it is known that interstate deliveries are being made and they are subjected to the order, indiscriminately, along with the intrastate deliveries.

5. The holding of the State court to the effect that the State may prescribe reasonable rates applicable to the interstate deliveries of gas is plainly wrong.

After holding that the deliveries made on appellant's Line A of gas transported through the State of Oklahoma were not interstate deliveries, the State court further held that even if these deliveries constitute interstate commerce, the State commission might validly regulate them because, in the view of the court, the prescribed rates were reasonable. (V, R. 3347-3352.) Said the State court:

"Where the rates are reasonable and are fixed according to some uniform, fair and practical standard they constitute no burden on interstate commerce." (V, R. 3350.)

" * * *

"The rate order in this suit does not in any manner interfere, restrain or burden the free transportation of gas between Texas and Oklahoma. Oklahoma gas may be freely transported to Texas and sold in the open market at the same reasonable rate fixed for Texas gas." (V, R. 3351-2.)

" * * *

"The order only attempts to regulate and fix the price for which such gas may be sold in Texas by appellee to its various distributing companies." (V, R. 3347.)*

*The State court's discussion of this question refers not only to the Wheeler County gas transported *through* Oklahoma but also to the gas produced or purchased by appellant in the State of Oklahoma and transported to city gates in Texas. The questions arising in connection with the gas produced or purchased in Oklahoma are elsewhere discussed, *infra*, pp. 104-110.

The holding of the State court is clearly wrong. The rate order operates as a direct regulation of interstate commerce and, for that reason, must fall. The State is without power to prescribe the rates, reasonable or unreasonable, applying to the interstate deliveries of gas. The question discussed by the State court is settled against its view by the prior decisions of this Court.

Missouri vs. Kansas Natural Gas Co., 265 U. S. 298;
Public Utilities Comm. vs. Attleboro Co., 273 U. S. 83, 89, 90;
Peoples Gas Co. vs. Public Service Comm., 270 U. S. 550, 554;
State Corp. Comm. vs. Wichita Gas Co., 290 U. S. 561, 563, 564;
State Tax Comm. vs. Interstate Natural Gas Co., 284 U. S. 41.

The State court's affirmance of the State's power is based upon its finding that the prescribed rate is *reasonable*. This assumes the very question to be decided—the power of the State commission to determine the issue of reasonableness. That the rate may be reasonable is not material where the question is one of power and not reasonableness. There can be no valid or *reasonable* exertion of usurped power. *Minnesota Rate Cases, 230 U. S. 352, 396, 401; Smith vs. Illinois Tel. Co., 282 U. S. 133, 148; Missouri vs. Kansas Natural Gas Co., 265 U. S. 298; Peoples Natural Gas Co. vs. Public Service Comm., 270 U. S. 550, 554.* The power to regulate being exclusively vested in the Congress, only the Congress may determine whether a given regulation is reason-

able. A determination of the issue of reasonableness is merely incidental to the proper exercise of the power of rate regulation—a power not vested in the State commission.

The holding of the State court is in conflict with the decisions of this Court that we have cited and with its ruling in an earlier and leading case, *Wabash, etc. Ry. Co. vs. Illinois, 118 U. S. 557, 575.*

The original cost of the gas at the wells is trifling as compared to cost of constructing and operating this interstate line used in transporting the gas in interstate commerce. The result is that the fixing of the city gate rate as here attempted is, in practical and legal effect, the fixing of the compensation that the utility may exact for the use of its interstate facilities; it amounts to the fixing of the utility's compensation for the transporting of the commodity in interstate commerce; for the performance of a public service in interstate commerce. It amounts, therefore, to a regulation of a matter of national and not merely local concern. *East Ohio Gas Co. vs. Tax Comm., 283 U. S. 465, 470, 472; Missouri vs. Kansas Natural Gas Co., 265 U. S. 298, 309; Public Utilities Comm. vs. Attleboro Co., 273 U. S. 83, 88, 89, 90.*

That appellant's business, viewed as a whole, may be predominantly local, as is asserted by the State court, does not change the fact that a part of its business is interstate and therefore national in character. The fact that the greater part of the business may be local in nature is not effective to extend the power of the State so as to enable it to regulate, in the direct way here attempted, that part of appel-

lant's business that indisputably is interstate in character.

The State court erroneously assumed, as is apparent from its opinion, that this order fixing the city gate rate is merely a local police regulation and valid, unless it discriminates against interstate commerce. Discrimination against interstate commerce is not material except where, absent such discrimination, the attempted regulation would be valid as a regulation of intrastate commerce. The rate order here challenged is a direct regulation of interstate commerce and for that reason must fall, however non-discriminatory it may be.

6. The failure of Congress to regulate gas pipe lines.

The State court refers to the failure of Congress to act and to the Federal statute providing that the Interstate Commerce Act shall not apply to gas pipe lines. (V, R. 3347.) Inasmuch as the rate operates as a direct regulation of interstate commerce, the failure of Congress to legislate on the subject is not material. Precisely the same contention was made, considered and expressly overruled in *Missouri vs. Kansas Natural Gas Co., 265 U. S. 298.** See also *State Corporation Comm. vs. Wichita Gas Co., 290 U. S. 561; Peoples Natural Gas Co. vs. Public Service Comm., 270 U. S. 550, 553, 554; Public Utilities Comm. vs. Landon, 249 U. S. 236; Public Utilities Comm. vs. Attleboro, 273 U. S. 83, 90.*

*In that case the State court held, as did the State court here, that since Congress had not acted, the State had the power to regulate "the sale of natural gas in this State by

The failure of Congress to regulate interstate rates does not enlarge the power of the states; nor does such enlargement flow from a mere denial by Congress of the power of a given Federal agency—the Interstate Commerce Commission—to impose the regulation. The only implication arising from that fact is that the Congress believed that regulation is not necessary. *Missouri vs. Kansas Natural Gas Co., 265 U. S. 298, 301; Minnesota Rate Cases, 230 U. S. 352, 396, 401; Oregon-Washington Co. vs. State of Washington, 270 U. S. 87, 102; Welton vs. Missouri, 91 U. S. 275, 282.*

7. Corporate affiliation between appellant and the distributing companies is not material to a correct determination of the interstate commerce issue.

The Court of Civil Appeals discusses at length the corporate affiliation between the appellant and the distributing companies, constituted by the fact that

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the Kansas Natural Gas Company." *State vs. Kansas Natural Gas Co., 111 Kan. 809.* The decision was reversed in this Court, *265 U. S. 298.* Appellants in support of their claim that the rates were subject to local regulation relied on the same authorities that are cited by the appellees in the Court of Civil Appeals here, including, principally, *State vs. Flannelly, 96 Kan. 372,* and *Manufacturers' Light & Heat Co. vs. Ott, 215 Fed. 940.*

The non-action of Congress and the provision of the Interstate Commerce Act exempting pipe lines from the jurisdiction of the Interstate Commerce Commission was also made the basis for the decision of the Pennsylvania court in *Peoples Gas Co. vs. Public Service Comm., 279 Pa. 252.* The holding of the Pennsylvania court on that question was expressly disapproved by this Court. *Peoples Natural Gas Co. vs. Public Service Comm., 270 U. S. 550, 553, 554.*

they are subsidiaries of the same parent corporation. (V, R. 3338-3344.)* The point attempted to be made by the court in this connection is not plain; the materiality of the discussion, even from the court's viewpoint, is not apparent. Its ultimate conclusion was that corporate affiliation was not material in determining the question of interstate commerce. Said the Court:

"The fact that appellee and affiliated distributing companies may be engaged in the integrated but single business enterprise of producing, purchasing, transporting, and selling natural gas to the ultimate consumer or burner tip user is not of controlling importance on the commerce issue; because the commission did not fix the burner tip rate, nor did it require the distributing companies to pay appellee not in excess of the 32-cent city gate rate, and to pass the 8-cent reduction on to the ultimate consumer or burner tip user." (V, R. 3343.)

The total import of the opinion of the State court on the point of corporate affiliation is that corporate entities should be ignored for the purpose of proving that appellant and the distributing companies are conducting a "single business"; and that appellant is conducting merely a "department" of that business. The State court does not hold that separate corporate entities will be ignored in the application and enforcement of the rate order.

The order of the commission respects separate corporate entities. The commission proceeded under Article 6053, R. S. 1925 (*infra*, p. 85), directly

*Two of the distributing companies are independent concerns.

against the appellant pipe line company as a separate and distinct corporation and fixed, by its order, the rate that the appellant might charge and collect from the *distributing* companies, treated by the order as separate corporations.*

The order has been copied, *supra*, pp. 6-7. It recites that the commission had instituted the proceeding on its own motion to inquire into the rates charged by appellant for gas sold to distributing companies, and it directs that the prescribed rate should apply to all gas sold at the city gates to all distributing companies. (*Supra*, pp. 6-7.)

The commission's findings of fact, constituting a part of the order, show that the commission was proceeding against the appellant as a pipe line company and as a separate corporate entity subject to regulation under Article 6053. These findings recite that the appellant is engaged in the "sale at *wholesale*" of natural gas; and that it operates "an integrated pipe line system" and engages in "both interstate and intrastate commerce." It is further stated by the commission that the only question to be determined was what rate should be charged by appellant at the city gates. (I, R. 14-16.)

It thus appears that nothing was involved except the rate applicable to the *wholesale* city gate deliv-

*This is illustrated by the commission's and State court's discussion of the advertising expense item. The commission "reluctantly" allowed this item, referring to the fact that in its view this expense was incurred for the benefit of the distributing companies. (I, R. 23-24.) The item was disallowed by the State court; the court stating that it was properly chargeable only against the distributing companies. (V, R. 3365-3366.)

eries of the pipe line company. Burner tip rates were not involved. No evidence was offered relating to the reasonableness of burner tip rates or as to the value of the properties of the distributing companies served by appellant or as to their revenues and expenses.

The holding of this Court in *Smith vs. Illinois Telephone Co., 282 U. S. 133, 143*, is directly applicable. There it was contended that corporate entity should be ignored and the American Telephone Company should be treated as the real party at interest. Discussing this contention this Court said:

"Upon these facts the City attacked the standing of the Illinois Company as the real plaintiff in the case. The court overruled this contention, holding that the ownership of stock by the American Company, and its power to control the Illinois Company, did not destroy the distinct corporate identity of the Illinois Company. The court pointed out that the order of the Commission was directed against the Illinois Company, and that it was treated as a corporation for the purpose of compelling it to establish the prescribed rates for service furnished by the operation of the property to which it had legal title. No ground appears for assailing this ruling. The fact that the relation of the Illinois Company to the American Company may demand close scrutiny, in dealing with certain questions which bear upon the validity of the rate order, cannot obscure the essential basis of that order, that is, that the Commission was imposing its requirement upon a corporate organization engaged in an intrastate public service and, as such, amenable to a valid exercise of the Commission's authority."

See also *Cannon Mfg. Co. vs. Cudahy Pkg. Co., 267 U. S. 333, 336, 337.*

Here the commission's order was directed against the pipe line company and it "was treated as a corporation for the purpose of compelling it to establish the prescribed rates for service furnished by the operation of the property to which it had legal title." (282 U. S. 144.) If appellant's corporate entity is to be recognized for the purpose of enforcing the rate order against it, then its corporate entity must be recognized in support of its attempt to prove that the order is void.

It is next submitted that the corporate affiliation between appellant and the distributing companies (excepting two of them, V, R. 3340) is wholly without effect in determining whether the deliveries in question constituted interstate commerce. The uninterrupted transportation of the Wheeler County gas from the Panhandle gas field and through the State of Oklahoma to city gates in Texas and Oklahoma constitute interstate commerce without regard to the ownership of the facilities transporting it. The city gate deliveries in Texas are as much interstate commerce as are the city gate deliveries in Oklahoma. On the other hand, the distribution and sale of gas through the local pipes to the burner tips is intrastate commerce without regard to the ownership of the facilities engaged in such local business. Regardless of the relationship between appellant and the distributing companies, the two activities are separated and are different in character. The reasoning of the State court on this question is point-

less. The relationship between the pipe line company and the distributing companies, however close, does not unify the two activities or avoid the fact that the State, not being content to regulate only the local activity, is here attempting to regulate the national activity. That is made plain by the decisions of this Court, beginning with the decision in *Public Utilities Comm. vs. Landon, 249 U. S. 236*, and including the following cases: *Pennsylvania Gas Co. vs. Public Service Comm., 252 U. S. 23; Missouri vs. Kansas Natural Gas Co., 265 U. S. 298; Public Utilities Comm. vs. Attleboro Co., 273 U. S. 83, 90; State Corporation Comm. vs. Wichita Gas Co., 290 U. S. 561, 563.*

The issue of interstate commerce is settled by the facts showing how the gas was transported and handled, that is, by the "course of business," and not by the relation between the various persons or corporations handling it. It may be transported by one company or by more than one, and the companies may be related or unrelated; the transaction is still one in interstate commerce. *East Ohio Gas Co. vs. Tax Comm., 283 U. S. 465; State Corporation Comm. vs. Wichita Gas Co., 290 U. S. 561, 563; Public Utilities Comm. vs. Attleboro Co., 273 U. S. 83, 90; Eureka Pipe Line Co. vs. Hallanan, 257 U. S. 265; Western Union Tel. Co. vs. Foster, 247 U. S. 105.*

This Court has held that where corporate affiliation is present, the fixing of the city gate rate operates as a direct regulation of interstate commerce. *State Corporation Comm. vs. Wichita Gas Co., 290 U. S. 561, 563.* See also *State ex rel Cities*

Service Gas Co. vs. Public Service Comm., 337 Mo. 809 (writ of cert. denied, *296 U. S. 657).*

In *State Commission vs. Wichita Gas Company, 290 U. S. 561,** there existed corporate affiliation as between the pipe line company and the various distributing companies. The Court in its opinion said:

"The Kansas statutes empower its public service commission to regulate the service and to fix rates to be charged by public utilities, including the distributing companies. They prescribe heavy penalties for failure to comply with commission-made orders. But the sale, transportation and delivery of natural gas by the pipe line company to the distributing companies constitutes interstate commerce and therefore the State is without power to prescribe rates or prices to be charged therefor. *Missouri vs. Kansas Gas Co.*, 265 U. S. 298, 305, *et seq. Peoples Gas Co. vs. Pub. Serv. Comm'n*, 270 U. S. 550, 554. *Pub. Util. Comm'n v. Attleboro Co.*, 273 U. S. 83, 90. *Smith v. Illinois Bell Tel. Co.*, 282 U. S. 133, 148." (290 U. S. pp. 563, 564.)

Here the Texas statutes authorize separate regulation, at least in part, of pipe line companies and distributing companies. As pointed out in the commission's findings, local distributing rates of all cities and towns having a population exceeding 500 inhabitants are fixed by the local governing authori-

**State Commission vs. Wichita Gas Co., supra,* involved only an inquiry as to the reasonableness of the city gate rate, considered as an expense item that might be set up by the distributing companies on their books. The order did not purport to fix any city gate rate binding either on the pipe line company or the distributing companies.

ties. *Article 1119.** There is a right of appeal to the commission. *Article 6058.* The commission has original and exclusive jurisdiction to fix the city gate rates of pipe line companies. *Article 6053.*†

Appellant and the distributing companies, excepting the two independent concerns heretofore mentioned, *supra*, p. 4, are subsidiaries of the same parent corporation. This does not mean that they are agents each of the other. But even if the distributing companies were appellant's agents, the rate order could not stand because it fixes, not the burner tip rate, but the rate that may be charged by appellant for transporting and delivering the gas in interstate commerce; it regulates the national activity carried on by the principal, as distinguished from the local activity carried on by the agent. The transportation of the gas through more than one State constitutes interstate commerce, and delivery at the end of the journey is an essential part of that commerce There can be no interstate commerce without delivery. This gas is interstate gas when it arrives at the city gates for delivery, and the contract between the parties defining the conditions upon which the gas will be delivered, including the price that must be paid by the agent to the principal, may not be regulated by the State.

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*The Court of Civil Appeals in its opinion directs attention to the fact that this population limit is 2000 inhabitants, the amendment reducing the limit to 500 having been held unconstitutional in *Texas-Louisiana Power Co. vs. City of Farmersville (Tex. Comm. App.), 67 S. W. (2d) 235.*

†The case of *United Gas Public Service Co. vs. State of Texas, et al.*, (unreported), decided by this Court on February 14, 1938, came before the commission on appeal under Article 6058.

The city gate deliveries to the distributing companies were made under term contracts specifying the rate applicable to wholesale deliveries. By its order the commission attempts to fix the terms and conditions under which these interstate sales and deliveries of gas may be made. This, the commission is powerless to do. *Shafer vs. Farmers Grain Co., 268 U. S. 189, 198; Lemke vs. Farmers Grain Co., 258 U. S. 50; Dahnke-Walker Co. vs. Bondurant, 257 U. S. 282, 290.*

Corporate affiliation of the parties to the contracts is not material. What is material and controlling is the fact that the parties have made contracts defining the terms and conditions under which these interstate deliveries of gas will be made.

The rate order, if valid, is binding whether corporate affiliation be present or not. The pipe line company would violate the order if it sold gas at a higher rate to any independent distributing company —and the record shows that two of the distributing companies are independent concerns. Will it be contended that the rate order is void as applied to the deliveries made to the two independent companies and valid as applied to the deliveries made in the same way to the affiliated companies?

The opposing argument, in effect, admits that if the gas were delivered to independent companies, the State regulation could not stand; the rate could be regulated only by the Congress. The authoritative pronouncement in *Missouri vs. Kansas Natural Gas Co., 265 U. S. 298*, requires this admission. The recognition of such a distinction would lead to anomalous and indefensible results. These results may

be illustrated by reference to the facts of this case. It appears from the evidence that there are two distributing companies doing business in the City of Waxahachie, Texas. One is the Municipal Gas Company, a corporation affiliated with appellant; the other is an "independent" corporation, the Waxahachie Gas Company. The appellant has contracts with and makes city gate deliveries of gas to each of these two distributing companies. (IV, R. 2312, 2342.) The contracts are substantially identical and the deliveries are made in the same way. Following appellees' contention as to the effect of corporate affiliation, the deliveries to the Municapal Gas Company, the affiliated distributing company, constitutes intrastate commerce, subject to State regulation. On the other hand, the deliveries to the Waxahachie Gas Company, the independent company, although made in the same way, constitute interstate commerce, to the extent that these deliveries include interstate gas, and are subject only to regulation by Congress. This difference in the exertion of regulatory authority is based, not upon any difference in the manner in which the gas was transported, sold and delivered, but upon the affiliation of the transporting company with one of the distributing companies.

Western Distributing Company vs. Public Service Commission, 285 U. S. 119, 124, is distinguishable because it did not involve any effort to directly fix the city gate rate. There was involved only the burner tip rate. The rate order here challenged applies directly against the interstate pipe line and prohibits it from charging any other rate. The Court

of Civil Appeals has held that if the prescribed rate is upheld, the adjudication will finally and conclusively determine its validity as against appellant. (V, R. 3349-3350.) In the *Western Distributing Company* case the Kansas Commission conceded that the city gate rate of the pipe line company was "an interstate rate and not the subject of regulation by any State authority." The parties to the contract were left free to perform the contract. Here the contract rate is stricken down and the commission's rate substituted for it.

Western Distributing Company vs. Public Service Commission, supra, merely holds that where corporate affiliation of the seller and the buyer exist and the rates of the buyer, a local distributing company, are under consideration, the regulatory authority, having admitted power to fix the local distributing rates, may properly consider and determine whether the rate paid by the distributing company to the affiliated pipe line company is a fair and reasonable rate for the gas delivered under the contract. This is done, not by way of regulating the pipe line company's rate, but by way of regulating the distributing company's rate; not by way of fixing the compensation of the pipe line company for transporting the gas in interstate commerce, but by way of fixing the compensation of the local distributing company; that is, by directly regulating that part of the business that is local in character, as distinguished from that part that is national in character.

Western Distributing Company vs. Public Service Commission, supra, merely follows and applies rules recognized in the decision of this Court holding that,

where corporate affiliation is present, contracts made between the affiliated parties will be scrutinized and will be upheld only upon a finding that they are reasonable. *Smith vs. Illinois Tel. Co., 282 U. S. 133, Columbus Gas Company vs. Public Utilities Comm., 292 U. S. 398, 400; Dayton Power & Light Co. vs. Public Utilities Comm., 292 U. S. 290, 295; United Gas Company vs. Railroad Commission, 278 U. S. 300, 320.* No decision of this Court lends any support to the contention that corporate affiliation in a case like this will be effective to change a given "course of business" into intrastate commerce where, but for the corporate affiliation, it would be interstate commerce.

Appellees emphasize *Pennsylvania Gas Co. vs. Public Service Comm., 252 U. S. 23.* The case involved only the burner tip rate. The business regulated was local and not national in character, and the regulation imposed was purely local in character. That is the ground upon which the decision must be upheld, if upheld at all, as was explained in *Missouri vs. Kansas Natural Gas Co., 265 U. S. 298, 309.* The decision in *Pennsylvania Gas Co. vs. Public Service Commission* was not based upon pipe line company ownership of the distributing facilities; correctly viewed, the decision would have gone the same way even if the distributing facilities had been owned by an independent company or by an affiliated company. Unifying the ownership of the pipe line and the distributing facilities, either directly or indirectly, would not change the character of the two businesses, one national and the other local. The facts of that case were controlled by the prior de-

cision of the Court in *Public Utilities Comm. vs. Landon, 249 U. S. 236.*

In *East Ohio Gas Company vs. Tax Comm., 283 U. S. 465, 472,* this Court said:

"It does not appear that there were presented, in *Pennsylvania Gas Co. v. Public Service Comm.*, to the state court or here the considerations on which it is held that interstate commerce ends and intrastate business begins when gas flowing through pipe lines from outside the State passes into local distribution systems for delivery to consumers in the municipalities served. But, however that may be, the opinion in that case must be disapproved to the extent that it is in conflict with our decision here."

In the same case the Court held that the transportation of gas from wells outside of Ohio in high pressure transmission lines to their connection with local systems "is essentially national—not local—in character and is interstate commerce within as well as without that State"; and, further, that the furnishing of gas to domestic consumers by means of distribution plants suitable for purely local service "is not interstate commerce but a business of purely local concern exclusively within the jurisdiction of the State. This was said in a case where the transporting pipe line company also owned the local distributing facilities.

It has been argued by the appellees that the commission is merely proceeding to do directly what it might have done indirectly by proceedings brought against the distributing companies and directly involving their burner tip rates. That in such proceedings the commission would have had the power to do

what was done in *Western Distributing Company vs. Public Service Commission, supra.* It is claimed, in effect, that the commission has arrived at the same result by a "short cut." As to this we submit:

(a) The commission has no *general* authority to *directly* fix burner tip rates. It has no jurisdiction of burner tip rates except as to towns whose population falls under the limit named in *Article 1119, supra.* As to other towns, its jurisdiction is simply appellate.

(b) As is admitted by the State court, the commission has not attempted to fix the burner tip rate. It is proceeding directly against the pipe line company and is attempting to do nothing except to fix the city gate rate.

(c) The power to fix the burner tip rate in a case where the pipe line company, transporting the gas to the city in interstate commerce, is also operating the distributing system within the city has been explained and upheld under the "original package" doctrine. The power was so explained in *East Ohio Gas Company vs. Tax Commission, 283 U. S. 465, 471.* See also *Public Utilities Comm. vs. Landon, 249 U. S. 236, 245,* and *Missouri vs. Kansas Natural Gas Co., 265 U. S. 298, 305.* The segregation of the gas in the local service lines where it remains awaiting the local demands for service is treated as a breaking of the "original package." "The treatment and division of the large compressed volume of gas is like the breaking of an original package, after shipment in interstate commerce in

order that its contents may be treated, prepared for sale, and sold at retail." *East Ohio Gas Co. vs. Tax Comm., supra.* But the regulation here attempted falls on the package before it has been broken. It therefore cannot be sustained. It will not do to say that the commission is merely proceeding to do directly what it might have done indirectly in an attempt to regulate burner tip rates—in an attempt to impose the regulation after the breaking of the package. To thus sustain the regulation would destroy the original package doctrine—the doctrine that protects the original package from direct regulation by State authority.

The decisions applying the original package doctrine draw a definite line. The national power exists on one side of the line and the State power on the other. The unbroken package is beyond, and the broken package within, the scope of the State power of taxation or regulation. It is immaterial that the line may be a narrow one.. That is true of all "lines" in the law. "The very meaning of a line in the law is that right and wrong touch each other and that any one may get as close to the line as he can if he keeps on the right side." (Per Mr. Justice Holmes in *L. & N. R. R. Co. vs. United States, 242 U. S. 60, 74.)*

8. The challenged rate order is an indivisible act of a legislative nature; and, being void as to the interstate city gate deliveries, it is also void as to the intrastate city gate deliveries.

That this rate order amounts to a direct and unconstitutional regulation of interstate commerce as

applied to the deliveries of the Wheeler County gas is clear. The next question involved is this: Is the order wholly or only partially void? Is the order divisible or indivisible?

(a) The order as written and as interpreted and applied by the Railroad Commission, and as upheld and enforced by the Court of Civil Appeals, applies to all city gate sales in Texas whether made in interstate or intrastate commerce. There was no attempted designation of certain cities and towns to which the rate should be applied, and no attempted limitation of the application of the order to city gate sales that might constitute intrastate commerce. It is plain that the commission was not willing to discriminate in imposing the regulation and in regulating the rate; it was not willing to leave unregulated certain city gate deliveries and to regulate others. It imposed a *uniform* state-wide city gate rate of 32¢ per MCF and made the rate applicable to all deliveries. The language of the order is:

"IT IS ORDERED, ADJUDGED AND DECREED that effective as of the next billing date the Lone Star Gas Company shall charge, bill and receive for domestic gas at the city gate from *all* distributing companies served by it, a rate not to exceed $0.32 per thousand cubic feet." (I, R. 116; our italics.)

The Court of Civil Appeals interpreted the order as applicable to all city gate deliveries in Texas without regard to any distinction between interstate and intrastate commerce. It held that if any of the city

gate deliveries constituted interstate commerce, they were nevertheless subject to State regulation provided the prescribed rate was a reasonable one. The opinion of the State court concludes:

"Judgment of the trial court declaring the rate to be unjust and unreasonable is reversed. The injunction granted by the trial court is dissolved, and the city gate rate of 32 cents fixed by the commission is declared to be just, reasonable and valid *in every* particular." (V, R. 3370; our italics.)

The operation of this order is defined in a single sentence and in general words. It applies to all deliveries made by appellant to "all distributing companies served by it." (I, R. 116.) What the Court said in *United States vs. Ju Toy, 198 U. S. 253, 262,* is directly applicable:

"But the relevant portion being a single section, accomplishing all its results by the same general words, must be valid as to all that it embraces, or altogether void. An exception of a class constitutionally exempted cannot be read into those general words merely for the purpose of saving what remains. That has been decided over and over again. *United States v. Reese,* 92 U. S. 214, 221; *Trade-Mark Cases,* 100 U. S. 82, 98, 99; *Allen v. Louisiana,* 103 U. S. 80, 84; *United States v. Harris,* 106 U. S. 629, 641, 642; *Virginia Coupon Cases,* 114 U. S. 269, 305; *Baldwin v. Franks,* 120 U. S. 678, 685, 689; *Smiley v. Kansas,* 196 U. S. 447, 455. It necessarily follows that when such words are sustained they are sustained to their full extent."

The rate order is an indivisible legislative act. It "is in terms single and indivisible." *Illinois Central*

R. Co. vs. McKendree, 203 U. S. 514, 529. The result is that the order may not be limited in its application to intrastate transactions. To do this would remake it—a legislative function. *Butts vs. Merchants, etc. Transportation Co., 230 U. S. 126, 135; Employers' Liability Cases, 207 U. S. 463, 502; Baldwin vs. Franks, 120 U. S. 678, 686, 688; James vs. Bowman, 190 U. S. 127; Trade-Mark Cases, 100 U. S. 82.* The order attempts an indiscriminate regulation of both interstate and intrastate commerce. It is therefore wholly void. *Cooney vs. Mountain States Tel. Co., 294 U. S. 384, 393.**

The Supreme Court of Texas, in dealing with legislative acts imposing, indiscriminately, a tax on or a regulation on both interstate and intrastate commerce, has held the acts to be entirely void. *Western Union Tel. Co. vs. Texas, 62 Texas 630; State vs. Humble Pipe Line Co., 112 Texas 375, 385, 386.*

In *Reagan vs. Farmers' Loan & Trust Co., 154 U. S. 362, 400,* this Court, discussing a rate schedule promulgated by the Railroad Commission of Texas, said:

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*It is pertinent, we think, to point out that in Texas the courts do not participate in the rate making process; they have no power to revise the rate of the Railroad Commission or the findings made in support of it. Their power is simply that of judicial review. *Railroad Commission vs. Weld & Neville, 96 Texas 394, 403; Railroad Commission vs. Uvalde Construction Co., (Tex. Civ. App.), 49 S. W. (2d) 1113, 1114.* See also the opinion of the State court in this case, V, R, 3356. Judicial participation in rate making is not permitted under the Texas Constitution. *Daniel vs. Tyrrell & Garth Investment Co., 127 Texas 213, 220.*

"As we have seen it, it is not the function of the courts to establish a schedule of rates. It is not, therefore, within our power to prepare a new schedule or rearrange this. Our inquiry is limited to the effect of the tariff as a whole, including therein the rates prescribed for all the several classes of goods, and the decree must either condemn or sustain this act of quasi legislation."

(b) Holding the order void as applied to interstate deliveries and valid as applied to intrastate deliveries would remake not only the order but the commission's basic findings made to support the order. The Court would be compelled to reconstruct the rate base and the operating account as found and considered by the commission. It would be compelled to consider, and make judicial findings relating to the value of properties, and as to operating revenues and operating expenses, wholly different from the properties and operating revenues and operating expenses considered by the commission as set forth in its findings.

The commission included in its rate base the value it assigned to appellant's Wheeler County gas producing properties and the value it assigned to appellant's Line A used in transporting the Wheeler County gas, including even that part of Line A which is located in the State of Oklahoma. The commission's findings as to appellant's operating revenues and operating expenses and as to what was required to cover a reasonable annual accrual to the depreciation and amortization reserve were based upon the inclusion and consideration of Line A, including even that part of Line A located in Oklahoma. All of appellant's properties and operations both in

Oklahoma and Texas were considered as "an integrated operating system." (I, R. 14-16.) It is impossible to revise the commission's findings so as to exclude Line A and the operations conducted thereon; and even if this could be done, there would remain no commission finding that the prescribed rate, considered and supported in such a way, was reasonable.

It further appears that the inclusion of Line A and the revenues accruing from that line greatly influenced the holding of the State court to the effect that the prescribed rate was not confiscatory. The court in its opinion refers to the fact that the operations on that line made a relatively small addition to appellant's operating expenses and a large addition to appellant's revenues. It clearly appears that the inclusion of the Line A properties and operations had an important bearing on the State court's conclusion that the prescribed rate was reasonable. We quote from the opinion of the State court as follows:

"Clearly the difference in theory as to whether the gas produced or purchased by appellee in the Texas Panhandle field and transported by its private pipe line across a corner of Oklahoma and back into Texas, where it was intended at all times to be sold and used, accounts for most of the important difference with respect to the fair value of the property used in Texas public service, the annual depreciation thereof, and particularly as to the operating expenses and revenues. For instance, the Texas Panhandle gas cost appellee 2 cents per thousand cubic feet at the well; whereas, the gas from all other sources or fields cost from 6 to 10 cents per thousand cubic feet. The advantage in favor of appellee in excluding this gas from intrastate commerce is apparent. The cost of

the 2-cent gas would add only about $125,000 annually to Texas operating expenses, according to Appellee's Exhibit No. 46; whereas, according to the same exhibit, which shows the percentage of the total cost of gas transported from the Panhandle field and sold in Texas, the Texas revenue would have been increased for the 1929-1933 period more than $1,500,000 annually; and calculations show that if other proper operating expenses were included and charged against the Panhandle gas, still the profit in such gas was more than in other gas handled by appellee either in Oklahoma or Texas. Thus the double advantage to appellee in freeing this gas from intrastate commerce and from state regulation is shown." (V, R. 3362.)

Considering these findings of the commission and the State court, it cannot be assumed that, with the Wheeler County gas and Line A operations excluded, the commission would have prescribed the same rate, or that a rate so prescribed would have been sustained by the State court. The contrary very clearly appears from the findings of the commission and the court.

(c) An order of a board or commission made in consequence of assumption of powers not possessed by it is void and its enforcement will be restrained. *Southern Pacific R. R. Co. vs. Interstate Commerce Commission, 219 U. S. 433, 451; Atchison, etc. R. Co. vs. Interstate Commerce Commission, 190 Fed. 591.*

It affirmatively appears from the commission's order that it proceeded upon the assumption, in promulgating the order, that it had authority to regulate interstate deliveries. In these circumstances,

and it appearing from the evidence in this case as well as from the commission's findings that appellant is engaged, in part, in interstate commerce, the order must fall.

Point Two.

The transportation, sale and delivery in Texas of the gas produced or purchased by appellant in Oklahoma constitutes interstate commerce. The rate order as applied to this gas is unconstitutional because amounting to a direct regulation of interstate commerce.

The facts relating to the transportation, sale and delivery at city gates in Texas of gas produced or purchased by appellant in Oklahoma have been stated, *supra*, pp. 30-34. Some of the legal questions here involved are identical with the questions arising in connection with the Wheeler County gas transported through Oklahoma. The discussion here will be confined to the points of difference.

That this Oklahoma gas arrives in Texas as an article of interstate commerce cannot be disputed. It is transported to Texas without interruption of movement, in high pressure lines, from the gas fields in Oklahoma.* The only question to be determined is whether the gas is so handled after it arrives in Texas that it becomes an article of intrastate commerce before it arrives at the city gates where the prescribed rate is applied.

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*The actual movement from one State to another is interstate commerce, notwithstanding the fact that both the gas and the pipe line are owned by appellant. *Pipe Line Cases, 234 U. S. 548 560, 561; Kelley vs. Rhoads, 188 U. S. 1, 8-9.*

1. The various points made by the State court in respect to this gas are untenable.

The various points made by the State court are now briefly considered:

(1) The State court first refers to the fact that after this Oklahoma gas arrives in Texas it is run through extraction plants "where the heavier hydrocarbons and volatile gasoline are extracted." (V, R. 3348.) In passing, we again direct attention to the fact that this statement is applicable only to the gas produced or purchased in Oklahoma. The Wheeler County gas is not run through a gasoline plant in Texas; all of it goes through an extracting plant at Hollis, Oklahoma.

What is done to the gas at these extracting plants very clearly appears from the testimony of the witness Schmidt, heretofore quoted, *supra*, pp. 31-32. It appears that the primary purpose of the appellant in running the gas through these gasoline stations is to eliminate operating troubles due to the freezing of the heavy hydrocarbons in the lines, and to put the gas in a more suitable condition for domestic consumption.

The uncontradicted testimony of the witness was to the effect that the forward movement of the gas was not interrupted at all by the process of running it through the extraction plants. (*Supra*, pp. 31-32.) *

*The rulings of the State court as to the effect of running gas through a gasoline absorption plant are inconsistent: The Wheeler County gas is run through such a plant at Hollis, Oklahoma, and is thereafter transported from Oklahoma to Texas and sold and delivered at city gates. If the running of the Oklahoma gas through the plants at

Under the decisions of this Court this handling of the gas is without effect on its character as a commodity transported in interstate commerce. *Carson Petroleum Co. vs. Vial, 279 U. S. 95; Southern Pacific Co. vs. Interstate Commerce Comm., 219 U. S. 498, 526; Ohio Railroad Comm. vs. Worthington, 225 U. S. 101; Stafford vs. Wallace, 258 U. S. 495; Heyman vs. Hays, 236 U. S. 178, 187;* see also *East Ohio Gas Co. vs. Tax Comm., 283 U. S. 465, 468.*

(2) The State court in its opinion says:

"At various points before delivery its pressure is reduced and the gas allowed to expand." (V, R. 3348.)

The expression "various points," considering the undisputed evidence, can only mean the city gates where the gas is delivered to the distributing companies. There is no evidence of any reduction in pressure except that effected by the regulators of the distributing companies. This reduction is made for the purpose of effecting delivery. There is, of course, a gradual and inevitable loss of pressure as the gas moves forward and the distance from the source of pressure increases. This is offset by the maintenance of compressor stations.

This Court has held that such a reduction in pressure as that here involved is immaterial in deter-

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Petrolia and Gainesville is effective to bring the gas to rest in Texas, making it an article of intrastate commerce, then it would seem that subjecting the Wheeler County gas to the same process at Hollis, Oklahoma, would have the same effect, with the result that when the gas is later transported to Texas it is transported in interstate commerce.

mining the interstate commerce issue. *State Tax Comm. vs. Interstate Gas Co., 284 U. S. 41, 43-44.* The reduction of pressure is merely incident to the delivery of the gas—a method of delivery. A "mere method of delivery is a negligible circumstance" in determining whether a given transaction or course of business constitutes interstate commerce. *Heyman vs. Hays, 236 U. S. 178, 187.*

Reference has been made to the fact that a part of this gas is run through compressor stations. The sole purpose of this is to facilitate the forward movement of the gas. (Schmidt's testimony, *supra*, p. 27.) It is therefore without effect on the issue of interstate commerce. *Ozark Pipe Line Co. vs. Monier, 266 U. S. 555, 560; Peoples Gas Co. vs. Public Service Comm., 270 U. S. 550, 552; East Ohio Gas Co. vs. Tax Commission, 283 U. S. 465, 468.*

(3) The State court in its opinion, discussing this gas produced or purchased in Oklahoma, says:

"Large amounts of it are run through and stored in wells on the Miller farm near the extraction plant in Texas, continuously, and for use later as needed." (V, R. 3348.)

Under the evidence this statement is correctly applicable only to a part of the Oklahoma gas. The undisputed evidence shows that only a part of it is stored in wells on the Miller lease. This rate order applies to all of the gas delivered at city gates in Texas, including the gas that is not stored, as well as the gas that is stored, on the Miller lease. If the storing of some of the gas on the Miller lease is effec-

tive to bring it to rest in Texas and to make it an article of intrastate commerce, that can have no effect on the part of the gas that is not so stored. It remains an article of interstate commerce and is so delivered at the city gates.

The rate order, as we have before pointed out, is an indivisible act of a legislative nature. It applies to all gas deliveries made by appellant at city gates in Texas, whether delivered in interstate commerce or intrastate commerce. The result is that the order is void as applied to the Oklahoma gas that is not stored on the Miller lease and, being void as to this part of the gas, it is wholly void. (*Supra*, pp. 97-104.)

(4) The State court states in its opinion that the Oklahoma gas has "no particular Texas city gate destination" and that after it is run through the extraction plants it passes into the pipe line system and is mixed and commingled with Texas gas until it is impossible "to trace or identify it by volume at any city gate of delivery." (V, R. 3348.) The order prescribes a uniform rate applicable to all deliveries at all city gates in Texas. It is therefore obviously immaterial whether a given quantity of gas may be delivered at one city gate or at another; the point of delivery is wholly without effect in applying the rate. If this interstate gas is delivered at any city gate—and manifestly it must be delivered at some city gate—it is subjected to this rate.

The commingling is immaterial because the quantities commingled are known. Furthermore, as we have previously pointed out, even if the quantities commingled were not known, the regulation could

not stand. It is sufficient that a quantity of Oklahoma gas, delivered in interstate commerce, is unlawfully subjected to this rate regulation. This being true, the order must fall, although the court may be unable to determine the amount of gas subjected to unlawful regulation. *Alpha Cement Co. vs. Massachusetts, 268 U. S. 203, 217; Heisler vs. Thomas Colliery Co., 260 U. S. 245, 259; Looney vs. Crane Co., 245 U. S. 178, 190.* We again direct attention to the fact that this discussion by the court of commingling is wholly inapplicable to the Wheeler County gas delivered at Wichita Falls, Texas, and at the city gates of the Texas cities and towns lying north and west of Wichita Falls. All of these deliveries are of Wheeler County gas uncommingled with any other gas.

(5) The State court compares appellant's deliveries of Texas gas with its deliveries of Oklahoma gas at city gates in Texas, and concludes that the amount delivered is relatively unimportant. The finding of the court as to the amount of Oklahoma gas is erroneous, as we have already pointed out, *supra*, p. 33. But, although the amount may be small, still, since it is transported and delivered in interstate commerce, it may not be subjected to this State regulation. Its immunity from State regulation does not depend upon its amount as compared with the amount of Texas gas.

The State court undertakes to compare the amount of the *Oklahoma* gas sold by appellant at city gates in Texas with the amount of *Texas* gas sold by appellant at city gates in Oklahoma, and undertakes

to use the Oklahoma city gate deliveries of Texas gas as an offset against the Texas deliveries of Oklahoma gas. The view of the court seems to have been that appellant was engaged in interstate commerce in delivering the Oklahoma gas at city gates in Texas only to the extent that such deliveries might exceed in amount its deliveries of Texas gas at city gates in Oklahoma. Both deliveries constitute interstate commerce. It is so clear as hardly to require statement that the character of appellant's interstate business of selling and delivering Oklahoma gas in Texas is in no way affected by its business of selling Texas gas in Oklahoma.

(6) The State court upholds the rate order on the ground that, even if the Oklahoma gas is interstate gas, the prescribed rate "in no manner interfered with, impeded, or burdened the flow of gas from Oklahoma, but such gas may be freely transported to Texas and sold in the open market at the same reasonable rate fixed for Texas gas." (V, R. 3352.) We have already discussed this plainly untenable holding, *supra*, pp. 79-82. The order is not challenged on the ground that it effects a discrimination against interstate commerce but on the ground that it directly regulates interstate commerce. Equality of treatment is not sufficient to sustain such a regulation.

Point Three.

The State court's holding that appellant's evidence, relating to the value of the entire "integrated operating system" and the revenues accruing there-

from and operating expenses incurred in connection therewith, was not material and should not be considered because of appellant's failure to make a proper segregation of its properties and operations, as between interstate and intrastate commerce or between Oklahoma and Texas, is plainly wrong.

This point is directed to the State court's holding that appellant's evidence showing the value of its properties, as well as its over-all revenues and expenses, was not material to any issue in the case and not entitled to be considered because it was not based on a proper segregation of appellant's properties as between interstate and intrastate commerce or as between Oklahoma business and Texas business. (V, R. 3361-2.)

The commission's order recites that it was based on the findings of fact stated in the order and on "such other findings and statements of fact, as are set out in the opinion next preceding this order." (I, R. 116.)

In the findings thus referred to, the commission found that appellant's Oklahoma and Texas properties constituted an "integrated operating system"; and that appellant's properties and operations had been thus considered. (*Supra*, p. 8.) The commission then proceeded to make detailed findings with reference to appellant's integrated properties and operations. These findings have been heretofore summarized, *supra*, pp. 9-10.

Appellees having offered the order to make out a *prima facie* case, and appellant's request for a directed verdict having been overruled, appellant then

offered the opinion and order and findings of the commission as the basis for its attack thereon (I, R. 312); and thereafter introduced evidence showing the book cost, reproduction cost new, fair value, gross revenues, expenses, allowance for depreciation, depletion and amortization reserve accrual, and income available for return. This evidence was offered on the theory and basis followed by the commission's findings. It dealt with appellant's properties and business operations in Texas and Oklahoma as an "integrated operating system," just as the same properties and operations had been considered by the commission in fixing the rate. This evidence has been heretofore summarized, *supra*, pp. 34-43. This evidence was in direct rebuttal of the commission's findings. It cannot be doubted that this evidence, if accepted by the triers of fact, was amply sufficient to demonstrate that the commission's findings were wrong.

This evidence was followed by additional evidence, introduced by appellant, showing, and being based upon, a segregation of appellant's properties and operations as between interstate and intrastate commerce. Appellees then offered evidence showing a segregation of appellant's properties attributable to its Texas operations from those attributable to its Oklahoma operations. (*Supra*, pp. 44-50.)

Appellees' evidence showed, and the Court of Civil Appeals found, that 85% of the appellant's properties were located in Texas. (V, R. 3337.) It further appeared that approximately 28% of its annual gas deliveries were transported from and, in Line A, through, Oklahoma. (*Supra*, p. 28.)

The trial court admitted all of appellant's evidence dealing with its integrated properties and operations. Repeated objections were made on the ground that the evidence was immaterial because no segregation as between Texas and Oklahoma operations, or interstate and intrastate commerce, had been made. (Illustrative, I, R. 325-6.) But all of these objections were overruled and the case submitted to the jury for a finding by it on the ultimate issue of confiscation.

We have heretofore summarized the court's charge to the jury, accompanying the special issue that was submitted. (*Supra*, pp. 15-17.) Considering the charge, the jury's answer to the single special issue submitted imported a finding that the rate was confiscatory. (*United Gas Public Service Co. vs. State of Texas*, unreported, decided February 14, 1938.) And, considering the charge as a whole, it is clear that the jury must have understood that, in answering the special issues submitted, they were to find whether the rate was so low that it would not provide "for a fair return upon the fair value of defendant's property used and useful in supplying the service furnished by said defendant"; that service being described as the deliveries "*to points in Texas.*" (I, R. 194.) The charge clearly required the jury to identify the property that was used and useful in rendering the service "to points in Texas," and then to find whether the prescribed rate as applied to the Texas deliveries would yield a fair return on the fair value of that property. Presumptively the jury followed the charge.

The trial court rendered judgment on the verdict

of the jury finding the rate to be confiscatory and enjoining its enforcement. (I, R. 197-199.) On appeal, the Court of Civil Appeals held:

(a) That appellant had failed to make a proper segregation of its properties and operations as between interstate and intrastate commerce; and

(b) That, because of such failure, the evidence it offered on the issue of confiscation was immaterial, wholly lacking in probative force, and not entitled to consideration, and that a verdict should have been directed against it.

This holding was applied to appellant's alleged failure to make a proper segregation of its properties. (V, R. 3361-3362.) The segregation appellant made was condemned and it was held that, since appellant had offered "no other proof on segregation or allocation of the property," the trial court erred in failing to direct a verdict against it. (V, R. 3361.) Upon the same ground the State court condemned as immaterial appellant's evidence relating to operating revenues and expenses. (V, R. 3364.)*

The court's holding is now discussed under separately stated points.

*The court here, and in other parts of its opinion, refers to appellant's failure to make a segregation as between interstate and intrastate commerce. This is inconsistent with the court's prior holding that appellant was not engaged to any extent in interstate commerce in Texas. Apparently the court used the term "interstate commerce" as referring to the Oklahoma operations and "intrastate commerce" as referring to the Texas operations. Otherwise, the court's holding is in plain conflict with its holding on the interstate commerce question.

1. The ruling of the State court in this connection denied appellant a fair opportunity to prove that the rate was confiscatory and amounted to a denial of due process.

The commission's order shows that it was based on the commission's findings made a part of it. The trial court instructed the jury that they were entitled to consider these findings in determining whether the rate was "unjust and unreasonable"—and therefore confiscatory, considering the definitions contained in the charge. The trial court permitted appellant to introduce evidence assailing these findings as they were made; that is, evidence showing the value of the entire integrated properties and the revenues and expenses connected with the operation of these properties. The Court of Civil Appeals held that this evidence was immaterial and should not have been considered at all, and that a verdict should have been directed against appellant because it failed to make a proper segregation of its properties and operations as between interstate and intrastate commerce or as between Oklahoma and Texas.

This action amounted to a denial to appellant of a "suitable opportunity" to challenge the validity of the order in a judicial proceeding. It was a denial of fair play and therefore a denial of due process, violating the Fourteenth Amendment. A fair hearing is essential to due process. "The right to such a hearing is one of the rudiments of fair play." *Ohio Bell Tel. Co. vs. Public Utilities Comm., 301 U. S. 292.* "The fundamentals of a fair hearing were not

conceded to the company." *West Ohio Gas Co. vs. Public Utilities Commission, (No. 1) 294 U. S. 63, 70.*

Any evidence tending to show that the commission's findings, upon which the order was based, were erroneous was admissible. By the court's charge, the jury was given the right to consider the findings in determining whether the rate was confiscatory. In these circumstances, appellant had the right to attempt to rebut the findings.

If the findings were discredited as to over-all value, they might also be discredited, from the standpoint of the jury, when limited to the value of the property rendering the service "to points in Texas." If the jury believed that the commission's over-all valuation was too low, it might well have concluded that its valuation of the Texas part of the over-all, 85%, was also too low.

Here, the appellant occupied a different position from that occupied by a plaintiff, and the vice of the opinion of the Court of Civil Appeals lies in its failure to recognize the distinctive nature of this proceeding. Here, the combined legislative-judicial process was initiated by the commission. When the proceeding had reached the stage of judicial review, the commission had defined the issues. It had promulgated, not merely a naked order without findings, but an order based upon, and, by reference incorporating as an integral part of it, definite findings. This the commission had done in order "that the courts might (will) understand why it had acted as it had," in contemplation of the court

action that normally would follow. *Norwegian Nitrogen Co. vs. United States, 288 U. S. 294, 319.**

At the commission hearing the commission selected the field of contest and issued its order after the conflict had been waged on the ground that it had chosen. By its findings it undertook to define the ground. When the commission fortified its order by findings, it invited a challenge of the findings, if the appellant would challenge the order. The Court of Civil Appeals has ruled that even though the findings were shown to be wrong, the order will prevail in deference to blind presumptions having no support in the findings.

The practical effect is to require the enforcement against appellant of a rate presumptively valid only because of findings that appellant is not permitted to assail. The effect is to give to the findings of the commission not merely presumptive correctness but irrebuttable finality.

A denial of the right to assail and discredit the findings, made a part of the order and furnishing the sole support for the order, was a denial of the right to assail the order itself.

When appellant carried its case to court for the purpose of challenging the order, of which the findings were made a part, it there assumed the heavy burden of establishing the invalidity of the order by "clear and satisfactory" evidence. The failure to attack the findings, supporting the order, by evidence

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*There is no need to consider whether the findings were indispensable. The order, however, was not "general legislation" but was "in the nature of a judgment directed against the individual concern." *Pacific States Box & Basket Co. vs. White, 296 U. S. 176, 186.*

directed to the issues tendered by the findings would have left them fully sustained by recognized presumptions. *Thompson vs. Consolidated Gas Co., 300 U. S. 55, 69.* In that state of the record, the appellant was entitled to challenge the order in a trial *de novo* in the State District Court by opposing the order with evidence directed to the findings. This was the order on which the commission had chosen to stand—an order of which the findings were a part.

Presumptively, the range of inquiry conducted by the commission and the scope of its hearing are aptly defined by the findings. The Court of Civil Appeals was not at liberty, in view of the Fourteenth Amendment, to uphold the order upon a presumption of validity that went beyond the evidence heard by the commission and the commission's findings. The holding of the Court of Civil Appeals amounted to a denial of "suitable opportunity through evidence and argument to challenge the result" of the commission's action. *West Ohio Gas Co. vs. Public Utilities Comm. (No. 1), 294 U. S. 63, 70.* The result, here, was the order and the findings. Without fair warning, the findings were, in effect, repudiated, and defense for the order was grounded on the assumption that the findings were of no importance. If the findings were of no importance, appellant was nevertheless entitled to show that they were *wrong*, in order to destroy the presumption that the order, resting upon the findings, was right. This appellant did to the satisfaction of the jury, and the court having control of the shaping of the issues at the trial. When the case came before the appellate court,

after it was too late to reshape the issues and when the appellant no longer had an opportunity to offer evidence and argument thereon, the Court held that the rebuttal of the findings was of no consequence and that the order should have been subjected to another and wholly different kind of test having no relation to the findings—a test that involved the segregated properties and operations, as distinguished from the integrated properties and operations.

In a constitutional sense, the case is no different from what it would have been if the District Court, after first ruling that appellant's over-all evidence was material and relevant, had at the close of the trial announced the opposing view and had then denied to appellant the right to offer additional proof to meet the exigencies of the new ruling. Such action, obviously, would have offended the rules of fair play. But the judicial process afforded by the State is to be tested in its totality. What boots it if the trial court accorded the appellant a fair trial when all that was done by the trial court has been nullified by the Court of Civil Appeals, and no opportunity afforded to meet the new ruling?

2. If a segregation was necessary, then the basis for a proper segregation was laid in the evidence and, presumptively, the jury, following the charge, made the segregation.

Evidence as to the over-all value of the entire "integrated operating system" was the essential basis for any segregation of property values as between the two States or as between interstate and

intrastate commerce. At all events, the reasonable way to proceed was to establish the over-all value and then apply a proper segregation factor to that value in order to arrive at the value of the property used in rendering the Texas service.

The commission's findings (*supra*, p. 9) and the appellant's evidence (*supra*, pp. 34-39) showed the over-all value. Appellees' evidence (*supra*, pp. 45-46) disclosed a basis for the segregation of the over-all value as between the two States. In this situation it was open to the jury to accept appellant's evidence showing the over-all value, as against the commission's findings as to over-all value.

The State court, accepting appellees' evidence, found that 85% of appellant's properties were assignable to Texas. (V, R. 3337.)

In this situation it was open to the jury to accept appellant's evidence showing the over-all value as against the commission's finding of over-all value. It was also open to the jury to accept appellees' evidence showing a segregation of the properties as between the two States and developing a percentage factor to be applied in making the segregation, and then to apply that percentage factor—85%— to the over-all value arrived at by the jury. So proceeding, the jury could have arrived at a reasonable and supportable conclusion that the rate was confiscatory even when considered in the light of the commission's findings relating to operating revenues and expenses or in the light of appellees' set-up of operating revenues and expenses.

Eighty-five per cent of the rate base, as shown by

appellant's evidence, would equal approximately $60,000,000.00. On that basis, and accepting even the appellees' evidence as to the operating revenues, expenses, and depreciation allowance, the rate of return would have been confiscatory, being approximately 4½%. Or, the jury could have found that the rate was confiscatory by accepting the rate base shown by the testimony of appellees' witnesses, $40,256,862.39, (III, R. 1900, V, R. 3360) and by accepting appellant's evidence as to what would be a *fair rate of return.* Thus it could have settled the issue of confiscation in appellant's favor by resolving in its favor the conflict in the testimony of the "equally well qualified experts" on the issue of fair *rate of return.* (*Supra,* p. 42.) The jury could have settled the confiscation issue in appellant's favor by taking appellees' segregated rate base of $40,256,862.39 and by adding thereto the value of appellant's production system properties, eliminated by appellees' expert witnesses, this amounting to more than $5,000,000.00. (*Infra,* pp. 162-165.) It will be noted that the trial court instructed the jury that in determining the confiscation issue they should consider the value of all of appellant's property "used and useful" in rendering the service in question, including its properties used in the "production * * * of natural gas." (I, R. 193-195.) If the jury followed the charge, it rejected appellees' elimination of the production system properties and put these values back into the rate base.

In these and other ways, the jury could have settled the confiscation issue in appellant's favor merely by exercising its undoubted power to select the evi-

dence satisfactory to it, regardless of its source. (*Infra*, pp. 159-170.) The jury was not required to accept appellant's evidence in its entirety or to accept appellees' evidence in its entirety.

The trial court did not hold that a segregation was unnecessary. It merely held that the evidence relating to the value and net operating revenues of the integrated properties—the very properties that had been valued and considered by the commission, as shown by its findings,—was admissible to be considered by the jury along with the commission's findings and all the other evidence in determining whether the rate was confiscatory. The trial court instructed the jury that they could consider the findings of the Railroad Commission for the purpose of assisting them in determining whether the rate order was "unreasonable and unjust to the defendant." (V, R. 194.) Manifestly, appellant had the right, in view of this charge, to have its over-all evidence considered in the same way, not as proving that no segregation was necessary, but as proving the value of the whole property, including the value of the part attributable to the Texas service.

None of the decisions of this Court hold that this evidence, relating to the "integrated operating system," was legally immaterial and inadmissible. These decisions merely hold that the basis for the segregation must be laid in the evidence; not necessarily in the evidence offered by the utility, considered alone, but in the evidence considered as a whole. That basis was laid in the evidence here. The jury were required by the charge, correctly construed, to make a segregation and to limit their consideration to the

property rendering the Texas service. The jury could have made the segregation on the basis shown in appellees' evidence, and then could have applied that segregation to any over-all rate base that the jury believed was established by the evidence.

Appellant's evidence can not be properly condemned because it did not include a segregation of properties and operations. It is sufficient that the evidence, considered as a whole, furnished a basis for the segregation which the jury must have made if it followed the court's charge. It can make no difference, as far as appellant's legal rights are concerned, who made the segregation. The ultimate question is not who made it but whether, once the segregation has been properly made, the fact-finding body has determined that the rate as applied to the segregated property is confiscatory.

Here the Court of Civil Appeals reverses the judgment apparently, not because a proper segregation was not made as a predicate for testing the rate, but simply because appellant's evidence failed to make the required segregation.

Smith vs. Illinois Telephone Co., 282 U. S. 133, is distinguishable. In that case there were no findings segregating the interstate from the intrastate properties and operations; there were no findings segregating the properties that were used in rendering the service to which the rate applied. Here there is evidence showing a segregation and there is a finding by the jury that the rate was confiscatory when tested by its application to the property "used and useful" in rendering the service "to

points in Texas." That finding supplies what was lacking in the Smith case.

Point Four.

The holding of the State court that the triers of fact were without power to settle conflicts in the evidence denied appellant an adequate judicial review of the rate order on the tendered issue of confiscation. It denied appellant due process.

The Court of Civil Appeals did not stop with its holding that a verdict should have been directed and judgment rendered against appellant, declaring the rate order "valid in every particular," (V, R. 3370) because of appellant's alleged failure to make a proper segregation of its properties and operations. It further held, in effect, that, at most, the evidence on the issue of confiscation was merely conflicting and that, in these circumstances, the law raised a barrier against appellant's attack on the rate in advance of an actual test.

On the issue as to the *value* of appellant's property, the State court said:

"At most, the evidence merely presented the difference of opinions of equally well qualified experts." (V, R. 3363.)

And again:

"Valuation of such public service property is in the main a matter of estimate or opinion, and closely resembles discretion as regards the finding of value by an administrative commission. In any event, a

scientific or statutory standard of absolute value is unattainable; and because of this uncertainty of value, except where the evidence clearly shows gross over or under valuation, or mistake, inequality or fraud in the appraisal, the finding of value by an administrative commission is generally given finality. Especially is this the rule in absence of an actual test under the new rate." (V, R. 3405-6.)

The conflicting evidence on the issue of value, to which the court refers is hereafter summarized, *supra*, pp. 34-50.

There was a clear conflict in the evidence as to what would be a proper *rate of return*. Even the Court of Civil Appeals conceded this. Referring to the fact that the commission had found 6% was a proper rate of return and to the conflict in the evidence as to what would be a proper rate of return, the State Court said:

"The burden was heavily upon appellee to show by clear and satisfactory evidence that such rate of return was confiscatory or unreasonable and unjust. To meet this test appellee was required to 'establish by evidence which leaves no reasonable doubt in the judicial mind that the rate or rule is unjust and unreasonable.' R. R. Comm. v. Galveston, etc., supra. It offered the testimony of an interested witness and the testimony of experts employed by it, to the effect that in their opinion an 8% or 10% rate of return would be reasonable. A disinterested expert testified that under present business conditions a 6% rate of return was entirely fa and reasonable. This evidence merely presented the difference of opinion of experts, and manifestly their opinion or opinions cannot be substituted for the finding of the Commission that a 6% rate of return was fair and

reasonable, which finding was based upon substantial evidence." (V, R. 3368.)

Considering the state of the evidence hereafter summarized, pp. 147-149, the whole issue as to whether the rate was confiscatory might have been settled by resolving the conflict in the evidence as to what would be a proper rate of return. Appellant's evidence on that important issue was condemned because it was merely in conflict with the opposing evidence offered by the appellees. Thus, it was definitely held that the reviewing court had no power to settle the conflicts in the evidence relating to a proper rate of return. According to the Court of Civil Appeals, the reviewing court was merely empowered to discover the conflicts and then sustain the rate order, leaving the conflicts unsettled.

The point here made is not based upon the failure of the Court of Civil Appeals to exercise an independent judgment as to the facts or its failure to make findings settling the conflicts in the evidence referred to. That court has no power under the State law to "set aside the verdict of the jury and substitute its finding, instead of the finding of a jury, and render judgment accordingly. * * * It has no power to make an original final determination of a question of fact." *Choate vs. S. A. & P. Ry. Co., 91 Tex. 406, 410; United Gas Public Service Co. vs. State of Texas, supra.*

Nor do we challenge here the proceedings in the State trial court as amounting to a denial of due process. There, the jury, as an arm of the court, exercised an independent judgment on the facts under a charge making it the exclusive judges "of the facts

proved, of the credibility of the witnesses, and of the weight to be given to their testimony"; (I, R. 192) and found the rate unjust, unreasonable, and confiscatory. This finding was made under the court's direction that such findings should be made only if the evidence in support of it was "clear and satisfactory." (I, R. 194.)

What we do complain of is the judgment of the Court of Civil Appeals, which, in effect, deprived appellant of the judicial review accorded it in the trial court and placed it in the same position as if that review had been denied by the trial court. Appellant's complaint is not that the Court of Civil Appeals has erroneously declared the State law applicable to the judicial review of rate orders. Appellant's complaint is that the procedure, provided by the State, as expounded and applied against it in the instant case, denies it an adequate judicial review of the rate order. What the Court of Civil Appeals said on the subject of judicial review of rate orders is the law of the State, at least for the purposes of this case. And appellant's complaint is that the law of the State, as thus declared and enforced against it, amounts to a denial of due process. The appellant challenges the correctness of the ruling that adequate judicial review is afforded where the reviewing court, discovering a conflict in the evidence, upon a trial *de novo*, must leave the conflict unsettled and render a judgment sustaining the rate order. This, in effect, amounts to a holding that the Fourteenth Amendment applies only to cases where the evidence is not conflicting. The rule thus declared is in clear conflict with the decisions of this Court. *Ohio Water*

Co. vs. Ben Avon Borough, 253 U. S. 287; St. Joseph Stock Yards Co. vs. United States, 298 U. S. 38, 51; Baltimore & Ohio R. R. Co. vs. United States, 298 U. S. 349, 368.

In *United Gas Public Service Company vs. State of Texas*, decided on February 14, 1938, this Court held that the complaining public utility had not been denied adequate judicial review of the challenged rate order. In that case, the evidence on the issue of confiscation was conflicting, in the view of this Court, and the conflict had been settled against the utility by the jury in the trial court. The trial court rendered judgment on the verdict sustaining the rate order, and that judgment was affirmed by the Court of Civil Appeals. This Court held that the utility had been accorded an adequate judicial review but had failed to obtain a verdict settling the issues of fact in its favor. This case stands in a wholly different light. Here, the jury settled the conflicts in the evidence in favor of appellant and found that the rate order was confiscatory. The trial court approved the verdict and rendered judgment annulling the rate order. The appellate court reversed the judgment of the trial court and rendered judgment declaring the rate order to be valid and directing its enforcement, and based its judgment, at least in part, on the view that the evidence being merely conflicting on certain vital points, was legally insufficient to sustain the rate order. The court, in effect, denied the right of the jury, or the District Court sitting without a jury, to settle conflicts in the evidence. According to the appellate court, the sole right and duty of the Dis-

trict Court was to ascertain the presence of a conflict in the evidence, and after finding the conflict, to render judgment sustaining the rate order.

It is true that in certain portions of its opinion the Court of Civil Appeals acknowledged the existence of the rule requiring a wider scope of judicial review than that just mentioned. Said the court in the course of a general discussion of the subject:

"The commission contends that the rate must be sustained against the attack that it is confiscatory and unreasonable and unjust because it does not yield a reasonable return on the fair value of the property when it is shown to be based upon substantial evidence adduced before the commission, and that only the evidence adduced before the commission on the rate hearing may be considered on appeal to the court. On the other hand, appellee contends that the hearing on appeal to the court of such issues is de novo and that 'due process of law requires submission to a judicial tribunal for determination upon its own independent judgment as to both law and facts according to the settled rules governing judicial action and decision. * * *' As regards the rate making power of the commission, the Texas courts have adopted this wider scope of review." (V, R. 3354.)

And again:

"But the questions of whether a rate is confiscatory or unreasonable and unjust have been held to be legal or justiciable questions of fact and as to which the wider scope of judicial appellate review seems to have been adopted by the Legislature and courts of this State." (V, R. 3357.)

What the court said must be distinguished from what it did. The requirement of due process,

recognized in the language just quoted, is denied effective operation in the court's statement and application of the rules governing the judicial review of rate orders in the District Court. This is apparent from the language we have previously quoted, *supra*, pp. 124-126, and from the action of the court in reversing the judgment of the trial court and rendering judgment against the appellant.

What the same court said in *United Gas Public Service Company vs. State of Texas, 89 S. W. (2d) 1094, 1102*, decided after the present case, is enlightening:

"* * * in advance of any actual test of the practical result of the new rate the court on appeal will not disturb the rate where it is based upon conflicting evidence as to valuations of property or as to any other item used as a basis for the calculation of the rate because to do so would likely substitute the finding of the court or jury upon conflicting evidence for that of the commission, and would therefore permit the court to exercise the legislative function of rate making."

Under the rules laid down and applied against the appellant in this case by the Court of Civil Appeals, the issue in a case like this is not whether the rate is confiscatory, but whether there is substantial evidence supporting it. The inquiry, according to the court, is directed, not to the validity of the rate, but to the existence of a conflict in the evidence relating to its validity. The rate must be upheld, not because it is reasonable, but because those supporting the rate say that it is.

And it is important to bear in mind that the con-

flicts which the court refers to are not the conflicts between the findings of the commission—which were abandoned and in effect repudiated by the appellees at the trial—and the testimony of appellant's witnesses. The conflicts to which the court gave conclusive legal effect in deciding the case against appellant are those between the testimony of appellant's witnesses and the testimony of appellees' witnesses at the trial. The evidence heard by the commission was not admitted in evidence in the trial court. The trial was entirely *de novo*. When the State court refers to the evidence sustaining the commission's order and findings, it is referring to the testimony heard *de novo* at the trial.

In the view taken by the State court, the evidence on the issue of confiscation in a rate case can never present an issue of fact. The question to be determined in every such case becomes solely one of law, depending for its solution on the presence or absence of a conflict in the evidence. In either instance, a verdict must be directed; in the one instance in favor of those supporting the rate because of a conflict in the evidence, and in the other, in favor of those assailing the rate because the evidence showing that it is confiscatory is undisputed. The practical operation of such a rule would mean that a rate can never be successfully attacked for there is always evidence "easily produced" in support of the "findings of the implicated board." *Chicago, etc., Ry. Co. vs. Osborne, 265 U. S. 14, 16-17.*

It is one thing to say that the reviewing court in a case like this must accept testimony that simply conflicts with the findings underlying the rate order

or with other testimony sustaining the rate order. It is quite a different thing to say that the reviewing court is not entitled to credit such testimony. In the case of a conflict in the evidence adequate judicial review requires the right of selection and that is wanting here.

The presumption of validity surrounding a rate order, properly promulgated by a duly authorized body, may be enough to cause a reviewing court with power to weigh the evidence and exercise its independent judgment as to the facts affecting the issue of confiscation, to accept the findings underlying the order if they are supported by substantial evidence. The point here is that the jury in this case did not see fit to do so. It settled the conflicts in the evidence against the validity of the rate order. What it has done, and the power to do it again, must be upheld if the right to an adequate judicial review is to remain. How can there be any adequate judicial review when there is no power to settle conflicts in the testimony; no power to determine what testimony constitutes evidence?

The existence of "substantial evidence" sustaining a rate order does not negative the existence of clear, definite and satisfactory evidence against the validity of the order. And the reviewing court, though having the right to credit the substantial evidence in favor of the order and sustain it, must also have the right to credit the clear, definite and satisfactory evidence against the order and strike it down. To say that a rate order is properly sustained when it is supported by substantial evidence does not mean that the order must be sustained if it

is supported by substantial evidence, without regard to the amount of evidence on the other side.

Much that has been said on this subject has been said in cases where the reviewing court had before it only the evidence heard by the commission, promulgating the rate, and the commission's findings based on the evidence heard by it. In every such case the conflicts in the testimony have been settled by the commission before the case reached the reviewing court, and the court was called upon, viewing the same record, to upset the action of the commission in settling the conflicts in a particular way. In Texas, judicial review of a rate order is *de novo;* and this order was thus reviewed. None of the evidence heard by the commission was placed before the jury. The jury, under the supervision of the trial court, was called upon to consider originally the conflicts in the evidence. In this situation conflicts must be settled in the District Court, or they cannot be settled at all.

The distinction here pointed out seems to have been recognized by this Court in *St. Joseph Stock Yards Co. vs. United States, 298 U. S. 38, 54.*

The practical result of the holding of the Court of Civil Appeals is that the rate order, duly challenged by appellant as being confiscatory, has been sustained and enforced against appellant notwithstanding the fact that admitted conflicts in the evidence, relating to matters affecting the issue of confiscation, were not settled and must remain unsettled. In these circumstances, of what value to appellant was the so-called *de novo* trial—a trial before a tribunal, empowered to hear evidence *de novo*, as

distinguished from the commission record, and yet without power to settle the conflicts in the evidence heard. This holding means that the reviewing court had the power to hear but no power to decide.

The holding of the Court of Civil Appeals means that while Texas has provided a tribunal empowered to find a conflict in the evidence, it has provided no tribunal empowered "to weigh the evidence and pass upon the issues of fact." *St. Joseph Stock Yards Co. vs. United States, 298 U. S. 38, 50.*

This Court, in *B. & O. R. R. Co. vs. United States, 298 U. S. 349, 368,* said:

"The due process clause assures a full hearing before the court or other tribunal empowered to perform the judicial function involved. That includes the right to introduce evidence and have judicial findings based upon it."

A decision in favor of the commission upon the trial *de novo*, merely because the evidence is conflicting, is no decision of the *case* at all. It is simply an announcement of judicial impotence, imposed on the reviewing court by the rule denying it the right to weigh the facts and settle conflicts in the evidence.

Point Five.

The finding of the jury that the rate was confiscatory is sustained by clear and satisfactory evidence. Therefore the judgment of the Court of Civil Appeals should be reversed and that of the district court affirmed.

What quantum and character of evidence is required to sustain a judgment setting aside a rate order, challenged as being confiscatory, is a matter of law—of Federal constitutional law. It is clear that this question has been erroneously decided by the State court.

The opinion of the State court discloses a failure on its part to understand the decisions of this Court, defining the test to be applied in determining whether a rate order is confiscatory. The Court of Civil Appeals announces that, where the evidence is conflicting and the conflict has been settled by the triers of fact against the validity of the order, their finding must be set aside and the rate sustained merely because of the presence of the conflict and without settling the conflict. There is no decision of this Court sustaining the ruling of the State court. The cases cited by the court involve entirely different states of fact.

The question involved here is what amount of evidence is sufficient to sustain a judgment invalidating a rate order as confiscatory. It is a case where the conflict in the evidence on vital points has been resolved *against* the order by the triers of fact.

The State court cites cases where the same kind of conflicts in the evidence were resolved in favor of the order by the triers of fact and where the utility on appeal was attempting to reverse the judgment. These decisions, correctly understood, apply here in support of, rather than against, appellant's position. For example, the State court and counsel for appellees greatly emphasize *Dayton Power & Light Co. vs. Commission, 292 U. S. 290, 299, 301,*

302. There the Supreme Court of Ohio, having full authority "to revise the findings of the commission in respect to fact and law" (292 U. S. 302), had settled the conflicts in the evidence in favor of the rate order and the question was whether this Court should overrule the findings of the State court. This Court in its opinion said:

"But plainly opinions thus offered, even if entitled to some weight, have no such conclusive force that there is error of law in refusing to follow them." (292 U. S. 299.)

"* * *

"Granting even that the testimony had an evidential value, it had that and nothing more. It had no such commanding quality as to apply coercion to the judgment of the appointed triers of the facts, and exclude every choice but one." (292 U. S. 301.)

Discussing the findings of the State court relating to the fair value of the utility's properties this Court said:

"Plainly in all this there has been no infringement of constitutional immunities unless a higher value has been made out by evidence too strong to be rejected. But for reasons already stated, the evidence is lacking in that high coercive power. Court and commission were free in their discretion to reject as unsatisfactory the conflicting opinions of a group of friendly experts." (292 U. S. 302.)

Here the independent triers of fact have resolved the conflicts in the evidence against the validity of the rate order. The conflicts in the testimony of the "equally well qualified experts" were settled

in favor of the appellant; and the rules announced in cases like the Dayton Power & Light Company case apply to sustain these findings.

The State court erroneously assumed that the rules announced in cases like the Dayton case apply only where the conflict is resolved in a particular way—that is, in favor of the rate order. These rules apply to sustain the findings without regard to the way in which the conflict was settled by the findings.

Other cases, similarly misapplied by the State court, are those where this Court has reviewed, on appeal, Federal equity cases, and where it was invested with the power to consider questions of fact as well as of law. Such a case was *St. Joseph Stock Yards Co. vs. United States, 298 U. S. 38, 50, 54.* In that case it was claimed that the order had not been properly reviewed in the lower Federal court. The Government, responding to this contention, invited this Court, sitting as an appellate court in a Federal equity case, to review the evidence under any proper test of judicial review. (298 U. S. 50.) This the Court did. See also *Lindheimer vs. Illinois Tel. Co., 292 U. S. 151.*

In a case appealed from the highest court of a State, this Court stands in a different position, the rule being settled that the findings of fact in the State court will not be re-examined on their merits in this Court. This rule has added force where the Court is called upon to examine a finding of fact made by a jury, because then the Seventh Amendment is applicable. *Dower vs. Richards, 151 U. S.*

658, 667; Jones National Bank vs. Yates, 240 U. S. 541, 552, 553.

However the opinion of the Court of Civil Appeals may be interpreted, appellant's right to an adequate judicial review was in practical effect denied. If the District Court had the power to adequately review the order, then appellant was wrongfully deprived of the result of that review by the judgment of the Court of Civil Appeals. It is not material whether the limitation on judicial review was stated by the Court of Civil Appeals as a rule specially limiting the judicial process locally provided in Texas for the review of such orders, or as a general rule of administrative and constitutional law limiting all courts in reviewing such orders. The result is the same: The order is to be enforced against appellant under the judgment of the State court without any provision for an adequate judicial review.

In determining whether the rate order has been proven to be confiscatory by clear and satisfactory evidence, the evidence must be viewed as a whole and must be considered in the light in which the triers of fact had the right to consider and blend it. It must be given the weight that the triers of fact were entitled to give it. In the instant case, the triers of fact, acting under a charge that affirmed their right to consider the credibility of the witnesses and the weight to be given their testimony, and that instructed them that the attack on the rate order must be sustained by clear and satisfactory evidence, have found that the rate order is confiscatory. If there is evidence in the record that they had a right to

accept, sufficient to constitute clear and satisfactory evidence, then their finding must be sustained.

We shall now review the evidence and undertake to demonstrate that when it is blended and considered as a whole in the way, in which the triers of fact were entitled to consider it, it shows in a clear and satisfactory way that the rate order is confiscatory.

1. The application of the rate considered in the light of the evidence as to appellant's integrated properties and operations.

The commission's order was shown by clear and satisfactory evidence to be confiscatory on the basis of appellant's evidence relating to its "integrated operating system"—the property and operations covered by the commission's findings. We have heretofore summarized this evidence; clearly the triers of fact were entitled to accept it. (*Supra*, pp. 34-43.)

Certain features of this evidence were specifically criticised by the Court of Civil Appeals. They are now discussed.

Federal Income Taxes. The court states that appellant claims between $300,000.00 and $400,000.00 a year for this item; that appellant has never paid any income tax, and that the only amount justified by the record is around $50,000.00 per annum. (V, R. 3364.) This is erroneous. The commission found "Federal income tax computed on the basis of 1931 actual earnings amounted to $302,302.41," (I, R. 104), but made no allowance for Federal income taxes in computing the amount available for return. (I, R. 105.) True, appellant

had not, for several years, paid income taxes directly. The payments were made by the parent company through a consolidated return. Since 1934 appellant has been required, by law, to make its own return and pay its own tax. The rate applicable, beginning January 1, 1934, was 13¾% of taxable income.

Appellees' witness estimated Federal income taxes payable on earnings from the Texas properties alone at $97,534.45 for the twelve-months period ended March 31, 1934, and $96,073.64 for the year 1933. (III, R. 1900.) There is no evidence in the record to support the court's statement that $50,000.00 would be an adequate allowance for the payment of Federal income taxes. Federal income taxes are proper deductions from earnings in computing the amount available for return. *Galveston Electric Co. vs. Galveston, 258 U. S. 388; Georgia Ry. & Power Co. vs. Railroad Commission, 262 U. S. 625.*

New Business Expenses. The Court of Civil Appeals says that appellant "proved only a small amount for advertising, nothing in proportion to the charges made by their experts in their accounts," and that the expense was "not supported by the quantum and character of evidence required." (V, R. 3365-3366.) The court was confused.

The amount claimed did not represent an expert's opinion; it was not an estimate, but an out-of-pocket operating expense. Appellees', as well as appellants', evidence shows the following sums actually expended for the item in question: For the year 1931, $126,125.98; 1932, $87,528.94; 1933, $99,793.94; and twelve-months period ended March 31, 1934,

$101,308.68. (Appellees' Ex. 5, III, R. 2131.) These outlays covered new business advertising salaries, new business solicitors and commissions, advertising supplies and expenses. The evidence shows that the expenses were incurred in good faith in the regular course of business and in the exercise of the management's best judgment.

"In all the pages of this record there is neither a word nor a circumstance to charge the management with fault." *West Ohio Gas Co. vs. Public Utilities Commission, 294 U. S. 63.* Appellant is as interested in increasing gas sales as the distributing companies. Reasonable sums expended for this purpose in the way of new business activities and advertising are legitimate charges to operating expenses. *West Ohio Gas Company vs. Public Utilities Commission, supra; Wichita Gas Company vs. Public Service Commission, 2 Fed. Supp. 792.* The court's criticism of the new business and advertising expenses is not justified by any of the evidence in the record.

Canceled and Surrendered Leases. The court's discussion of this item of expenses shows that the court was confused. (V, R. 3366.) It states that the undisputed evidence is that appellant's gas reserves are adequate for forty years to come. This is error. The only testimony in the record on this point is that they would last approximately twenty years. (I, R. 531; II, R. 1336.) The court says that the commission allowed appellant for gas produced from its wells the full prevailing price, eliminating production expenses, drilling and tool expenses, dry holes, canceled and surrendered leases,

and other items. This is error. The court confuses the commission with the experts who testified for appellees upon the trial. The commission made no such allowance, nor did it make such eliminations. It made an allowance for canceled and surrendered leases in promulgating the order. It said: "Cancelled and surrendered lease expense amounted to $239,230.96 for the year 1931. * * * Cancelled and surrendered lease expense is incurred whenever the company drills a dry hole on an undeveloped lease and decides that the whole lease is dry; whenever an undeveloped lease is proven dry by any other operation; whenever the company deems the prospective gas not worth the delay rentals; or whenever for any reason the company decides that the lease is not of sufficient value to continue to pay delay rentals; when an undeveloped lease is cancelled and surrendered, it is charged off at its original cost plus all delay rentals and any acquisition costs that have been set up on the books of the company." (I, R. 28.) The commission found that the average expense for canceled and surrendered leases for the five-year period ended December 31, 1931, amounted to $99,140.73 per annum, and allowed this amount for the year 1931, the year upon which it based its findings in computing its order. (I, R. 30, 104.) Appellees' own testimony showed actual charges for this item as follows: 1931, $239,230.96; 1932, $255,829.03; 1933, $188,629.92; and twelve months ended March 31, 1934, $169,362.09. (Appellees' Ex. 5, III, R. 2126A.) For Texas properties only, appellees' Exhibit 4 showed: 1931, $232,271.16; 1932, $245,103.65; 1933, $176,139.67; and twelve-

months period ended March 31, 1934, $166,304.21. (III, R. 2116A.)

The court also confused canceled and surrendered leases with gas reserves and depletion. Depletion expense is intended to provide for amortizing the producing leaseholds. The nature of canceled and surrendered lease expense is explained in the excerpt from the commission's opinion quoted above. Such expense may be handled in either one of two ways. It may be charged either to current operating expense or it may be provided for by reserve accruals. Both methods are recognized by the United States Bureau of Internal Revenue. In the instant case neither appellant nor appellee set up a reserve accrual for this purpose. In view of this fact it was proper to charge it as an operating expense. This is what appellant did. The amounts charged were reasonable. In any event, the commission's average was not assailed by appellees. Appellees' witnesses at the trial purported to include this expense in allowing the well head price for gas. Some allowance must be made if confiscation is to be avoided. What was a reasonable charge was not a matter of law, but a matter of fact for the jury.

Regulatory Commission and General Expenses. Speaking of this item, the Court of Civil Appeals said: "The experts employed by appellee charged in excess of $400,000.00 per annum for regulatory commission and general expenses." We cannot identify this figure in the record. Regulatory commission expense, however, does definitely appear. It is an out-of-pocket expense—not a matter of opin-

ion as the court's statement seems to imply. The commission allowed $17,695.86, this being the sum expended in 1931, saying: "Expenditures necessary for the preparation of inventories, for a reasonable number of evaluations, and for a presentation of all relevant facts to this commission and to the courts are properly chargeable to this account. The 1931 regulatory expense was not relatively large. Whenever such expense is relatively large, it should be amortized over a reasonable length of time, say ten years." (I, R. 22.) Appellee's accounting exhibit showed that the regulatory expenses were: 1931, $17,695.86; 1932, $163,739.01; 1933, $66,792.39; and for the twelve months ended March 31, 1934, $56,204.18, or a total of $304,431.44 for the four accounting periods. (Appellees' Ex. 5, III, R. 2131.) If amortized over a five-year period, it would amount to approximately $61,000.00 per annum, and $30,500.00 per annum if amortized over a ten-year period. It is uniformly recognized that reasonable regulatory commission expenses are a proper charge against operations. *West Ohio Gas Co. vs. Public Utilities Commission, 294 U. S. 63.*

Going Value. The only specific criticism made by the Court of Civil Appeals of the amount claimed by appellant as the fair value of its property related to going concern value. (V, R. 3367.) It rejected appellant's claim for going concern value because it had "not experienced any loss on account of inception costs, which are usually included in going value," and because "the reproduction cost new value, as determined in the instant case, allows for

all overhead expenses, which, together with the reasonable operating expenses allowed, fully compensate appellee for all development costs which have been incurred, and are ample cover items entering into and forming a part of what is referred to as 'going concern value.'" (V, R. 3367.)

Appellees included nothing in their appraisal for going concern value. Their expert testified as follows:

"Q. Well, did you include anything in your exhibit 6 for what is commonly known as going value, going concern value, or cost of reproducing the business?

"A. No." (III, R. 1793-94, 2108.)

The commission made no specific allowance for going concern value, and in our view it made no allowance whatsoever therefor. The commission thought that because it had allowed for all collateral construction costs and had not valued the property as junk, it had sufficiently compensated for the going concern value. (I, R. 66.) All parties admit that a going concern value inheres in appellant's property and business.

The amount claimed by appellant for going concern value was estimated by the witness Connor. Connor prepared and sponsored in evidence an exhibit which covered the subject exhaustively. (Appellant's Ex. 28, IV, R. 2914—V, R. 3006.) Connor based his estimate on a thorough study of the history and circumstances of appellant's property and business. He took into consideration that appellant's property and business was well established; that it

had been operating for approximately 24 years and was serving approximately 230,000 domestic and 1400 industrial consumers at the date of inquiry; that appellant, after much difficulty over a period of years, had secured and consolidated a diversified supply of gas ample to meet the maximum requirements of its consumers; that its property was well constructed, well maintained and so located as to meet the future growth of the territory that it serves. That appellant had a trained, efficient, operating personnel; that its credit was good; that there was demand for its service and that under reasonable rates it could earn a fair return on the fair value of its property. (II, R. 989.)

Connor showed in exhibit form the historical rate of business attachment on four of appellant's major pipe line systems. (Appellant's Ex. 48, V, R. 3318-3321.) He studied the history of business attachment to these pipe lines beginning with the date they were put in service and extending to the date of inquiry. He made a careful study of the existing system and markets and an analysis of the historical rate of business attachment for the cities and towns served by appellant. The way and manner in which appellant's witness arrived at going concern value meets controlling tests laid down by this court. It is fully explained in the record and need not be further detailed here. (II, R. 988-1013.)

That there is an element of value in appellant's assembled and established system which is doing business and capable of earning a reasonable return with reasonable rates, and that such value is a property right which should be considered in determining

the value of the property upon which appellant has a right to make a fair return, can not be doubted. *Los Angeles Gas & Elec. Corp. vs. Railroad Commission, 289 U. S. 287, 313-315.* There was no margin in the commission's rate base or appellees' appraisal for this property right.

We submit that a reasonable allowance should have been made to cover this item. What was a reasonable allowance was a question of fact for the jury.

Rate of Return. In disposing of appellant's contention that the jury may have found that a 6% rate of return was confiscatory or unreasonable and unjust, the Court of Civil Appeals said:

"We are clear in the view that the evidence adduced by appellee (appellant here) did not raise a jury question as to whether a 6% rate of return was either confiscatory or unreasonable and unjust."

The court then referred to the conflicting evidence and concluded that "this evidence merely presented the difference of opinion of experts, and manifestly their opinion or opinions can not be substituted for the finding of the commission that a 6% rate of return was fair and reasonable, which finding was based upon substantial evidence." (V, R. 3368.)

What annual rate will constitute just compensation depends on many circumstances and must be determined by the exercise of a fair and enlightened judgment having regard to all relevant facts. It involves a determination of what rate of return will be reasonably sufficient to assure confidence in the financial soundness of the enterprise and be adequate under efficient and economical management to main-

tain and support appellant's credit and enable it to raise the money necessary for the proper discharge of its public duties. *Bluefield Waterworks & Improvement Co. vs. Public Service Commission, 262 U. S. 679, 692, 693; Los Angeles Gas & Elec. Corp. vs. Railroad Commission, 289 U. S. 287, 319, 320.* It is clear that the question presents a fact issue determinable by the jury in this case.

Appellant offered the testimony of two experienced bankers, Messrs. Thornton and Florence, who testified that a return of 8% would be reasonable. Other witnesses testified to the same effect. These witnesses gave the basis of their conclusions. (Page 42, *supra;* also, Thornton, III, R. 1960-1965; Florence, III, R. 1965-1977.)

Appellees' principal witness on rate of return, a University professor, testified that at the date of inquiry no return at all would be reasonable, but that over a period of ten years 5% would be exceedingly liberal. (III, R. 1815-1816.) This witness gave no satisfactory basis for his conclusion. There are other facts to support a finding that a 7% or 8% rate of return would be reasonable.

The jury were clearly entitled to accept the testimony of appellant's witnesses on the issue of *fair rate of return* as against the testimony offered by appellees' witnesses on the same issue. That this testimony when accepted by the jury would constitute clear, definite and satisfactory evidence of confiscation cannot be denied.

What we have said here is correct without regard to the decision that may be made concerning the alleged failure of appellant to properly segregate its

properties and business as between Oklahoma and Texas, or interstate and intrastate commerce. If the jury resolved the conflict in the testimony of these "equally well qualified experts" on the issue of fair return in favor of appellant, then the rate was shown by clear and satisfactory evidence to be confiscatory even on the basis of the commission's own findings as well as on the segregation of properties and operations sponsored by appellees' witnesses at the trial. A determination of the issue of fair rate of return in favor of the appellant would necessarily have determined in its favor the entire issue of confiscation under any possible view of the evidence.

Depreciation, Depletion and Amortization Reserve Accruals. The Court of Civil Appeals compares appellant's estimate of $3,465,123.36 with appellees' estimate of $831,946.08 for annual reserve accruals for depreciation, depletion and amortization. (V, R.. 3363.) It also compares appellant's estimate with the actual charges against the reserve for the years 1927 through 1933. Upon the basis of these comparisons it concludes that appellant's estimate is at war with experience and plainly excessive. It concludes that appellant's estimate was of no probative force. In making these comparisons, statements and conclusions, the court states that the commission made certain estimates. The court is here actually referring to appellees and not to the commission. The commission allowed $968,066.98 for annual reserve accruals, whereas appellees estimated only $831,946.08 for depreciation.

Appellant's estimate is based upon the straight line

method, the method employed by appellant over a period of approximately twenty-five (25) years in its reserve accrual accounting. (II, R. 1260.) The straight line method is quite generally used and preferred for properties with units of varying life such as those involved in this case. *Lindheimer vs. Illinois Bell Telephone Co., 292 U. S. 150; Clark's Ferry Bridge Company vs. Public Service Commission, 291 U. S. 227.*

The estimates of appellant and appellees are not comparable. The differences in methods employed call for different rates and different annual amounts. Appellees' witness testified that if he had employed the straight line method he would have used 4.205% of the reproduction cost new of the depreciable property and 3.09% of the total rate base (III, R. 1874) instead of 2.11% which he used under the sinking fund method. (III, R. 1843.)

The estimates are not comparable for other reasons. Appellees' estimate included nothing for depreciation and depletion on appellant's Texas production system properties. (III, R. 1795.) Appellees' estimate covers only the properties located in Texas, exclusive of the production properties, whereas appellant's estimate covers the integrated operating system. Appellant's estimate provides $146,000.00 per annum for depletion of gas reserves, (V, R. 3055, 3196), and $421,316.00 for depreciation of gas well construction and equipment. (V, R. 3141.) Appellees' estimate makes no provision for depletion and depreciation on this type of property, which is admittedly the most highly depreciable item of property in appellant's system. (III, R. 1874.) It

is clear, therefore, that without regard to the basic differences in the calculations between appellant and appellees, a comparison of their respective estimates for reserve accruals is unsound because appellees' estimate includes only a part of the integrated operating system, whereas appellant's estimate includes all of the property in the system.

The court's comparison of the actual charges against reserve with appellant's estimate and its conclusion that because the estimate exceeds the charges it is "speculative, at war with actual experience, and plainly excessive" is fallacious. It is an accepted fact that reserve accruals should consist of uniform charges against operating revenues to meet the impact of increasing and fluctuating costs of replacements, removals and abandonments of capital items used in the service. *Lindheimer vs. Illinois Bell Telephone Co., 292 U. S. 150.* In the case of natural gas reserves, wasting assets, the accruals must provide for final exhaustion thereof. *Columbus Gas & Fuel Company vs. Public Utilities Commission 292 U. S. 398.*

As respects appellant's property, it is important to bear in mind that it has had a rapid growth in recent years. At the date of inquiry it was not the same property that was in existence when charges against reserves were made in past years. It was a larger and newer property at the date of inquiry because of large extensions and additions in recent years. At the date of inquiry its weighted age was only twelve years. (Page 39, *supra.*) As the pipe lines and other depreciable property grow older, the mortalities occasioned by depreciation, depletion,

public requirements and changed operating conditions will increase. The Court of Civil Appeals failed to consider the special conditions of a growing plant; that there are plant groups in operation upon which depreciation is accruing, but which are not yet represented or are but slightly represented in the retirement losses. The court has failed to consider that "where, as in this instance, there has been a rapid growth, retirements at one point of time will relate for the most part to the smaller preceding plant, while the depreciation reserve account is currently building up to meet the 'increased eventual retirement liability' of the enlarged plant." *Lindheimer vs. Illinois Bell Telephone Co., 292 U. S. 150.*

If proper recognition be given to the fact that the rate of replacements, removals and abandonments in a property such as that under consideration increases with age and use, then it becomes apparent that an estimate of the average future rate of these occurrences can not properly be assumed to be "at war with realities" by reason of the fact that it exceeds the past rate of mortalities. It is axiomatic that the converse is true; that where a variable rate of occurrences which increase with age and use are involved an estimate of the future average rate that did not exceed the past rate would be contrary to the basic principle that the rate was an increasing variable.

Another reason why charges against the reserve are not comparable with appellant's accrual estimate is that the estimate provides for amortizing certain classes of property, whereas no charges have

been made against reserve for property which is still in service, but which is yearly approaching the end of its life and for which an amortization accrual must be currently made. Appellant's estimate includes $350,515.00 for amortization. (Exhibit 42, V, R. 3192.)

Appellant's estimate was predicated in every particular upon its actual experience from the beginning of operations, after giving effect to every factor which would tend to insure accuracy and after testing the accuracy of the conclusions reached by every available check. (Pages 37-39, *supra.*)

In the final analysis, the weight that should be given an estimate or determination of annual accruals for depreciation, depletion and amortization must largely depend upon the qualifications and experience of the individuals making the estimate, the extent and accuracy of the available historical data and the interpretation of the data and their application to the property. Appellant's witness Connor was well qualified and thoroughly experienced. He had access to and analyzed an impressive amount of historical data. (Pages 37-39, *supra.*) Appellees' estimate would have provided for only 61.8% of the removals and replacements actually made by appellant up to the date of trial. (III, R. 2000-2001.) If appellees' rate of accrual had been applied to the property in service each year prior to the date of inquiry, rather than the property in service at the date of inquiry, it would have been inadequate to meet actual requirements. (III, R. 2027-2033.) Appellees' estimate was admittedly inadequate to meet the calculated future mortalities

unless supplemented by the existence and use of a credit balance in reserve account at the date of inquiry of $5,000,000.00 for transmission lines alone. (III, R. 1861.)

It was for the jury to resolve the conflicting evidence on the subject and to weigh the opposing contentions and conflicts, and to pass upon the credibility of the witnesses. In doing so they had a right to reach a conclusion favorable to appellant. The evidence clearly supports such a conclusion. "The question of the amount which should be allowed annually for depreciation is a question of fact." *Clark's Ferry Bridge Company vs. Public Service Commission, 291 U. S. 227.* The jury had a right to say in the light of all the circumstances what amount should be allowed for annual reserve accruals. *Columbus Gas & Fuel Company vs. Public Utilities Commission of Ohio, 292 U. S. 398, 406.*

The amounts available for depreciation, depletion, Federal income tax and return under the 32 cent rate, after adjusting operating expenses in accordance with the findings of the commission, were: For the year 1931, $3,765,160.24; 1932, $3,908,663.51; 1933, $2,997,969.38; and the twelve-months period ended March 31, 1934, $3,191,162.50. (III, R. 2270-2271.) These figures eliminate controversial items of expenses. Management fees and other expenses eliminated by the commission have been eliminated in arriving at them. The jury may have accepted these figures. If they had agreed to the inclusion of expenses eliminated by the commission, the amounts available for depreciation, depletion, Federal income tax and return would have been less than is shown

by these figures. They are being used, however, for the purpose of demonstration.

The actual costs of the property are set out at pages 36-37, *supra*. These costs include nothing for cash working capital. The commission estimated cash working capital at $1,488,369.91. If this amount be added to the actual cost and the accrued depreciation be deducted therefrom as determined by appellant's experts, this determination as shown in appellant's Exhibit 34 (V, R. 3037) being undisputed and unchallenged, the following amounts would represent actual costs depreciated rate bases:

	Before Deducting Accrued Depreciation	Percent Condition of New	Actual Cost less Accrued Depreciation
12-31-31	$49,265,119.54	94.26	$46,437,301.67
12-31-32	51,522,801.61	94.26	48,565,392.79
12-31-33	51,325,395.97	94.26	48,379,318.23
3-31-34	51,361,131.00	94.26	48,413,002.08
Average	50,868,612.03	94.26	47,948,753.70

If the 5% annual rate for depreciation and depletion determined by appellant's expert be applied to the actual costs depreciated rate bases, it results in the following amounts for reserve accruals:

12-31-31	$2,321,865.08
12-31-32	2,428,269.64
12-31-33	2,418,965.91
3-31-34	2,420,650.10

If these amounts are deducted from the sums available for depreciation, depletion, Federal income tax and return shown above, there remains available

for Federal income tax and return on the depreciated actual costs rate bases the following percentages:

12-31-31	3.11%
12-31-32	3.05%
12-31-33	1.20%
3-31-34	1.59%

If the jury had accepted the testimony of appellees' expert that in estimating annual reserve accruals by the straight line method he would use 3.09% on the total property, both physical and non-physical, and this percentage had been applied to the actual costs depreciated rate bases, it would result in the following reserve accruals:

12-31-31	$1,434,912.62
12-31-32	1,500,670.64
12-31-33	1,494,920.93
3-31-34	1,495,961.76

After these amounts are deducted from the sums available for depreciation and return shown above, there remains available for return on the depreciated actual costs rate bases the following percentages:

12-31-31	5.02%
12-31-32	4.96%
12-31-33	3.11%
3-31-34	3.50%

If the jury had accepted appellant's reproduction cost new estimate for the physical properties in the amount of $60,054,589.57 and appellant's determination of their percent condition of new, which was the only evidence introduced on this point, they

would have found a present value of $55,809,205.16. (V, R. 3037.) This figure does not include preliminary and organization expense, working capital or going concern value. Adding to this figure, as the jury may well have done, the commission's allowance for preliminary and organization expense in the amount of $231,555,30, and cash working capital in the amount of $1,488,369.91 (I, R. 52), they would have arrived at a present value of $57,529,130.37, exclusive of going concern value.

Appellant's expert estimated this annual requirement at $3,465,123.36, or approximately 5% on the total value ascribed to the property by appellant. (Page 37, *supra.*) This estimate was based on the straight line method and requires a depreciated rate base. If the 5% be applied to $57,529,130.37 suggested above, which was determined after deducting accrued depreciation, $2,876,456.51 results. This amount should be deducted from the amounts shown above to be available for depreciation, depletion, Federal income tax and return. When this is done, the following amounts are available for Federal income tax and return on the rate base of $57,529,130.37:

12-31-31	1.54%
12-31-32	1.79%
12-31-33	.21%
3-31-34	.55%

On the other hand, the jury may have accepted the testimony of appellees' expert that in estimating annual reserve accruals by the straight line method 3.09% of the total property, both physical and non-physical, should be used. If this percentage be

applied to the rate base of $57,529,130.37, it results in an annual accrual of $1,777,650.12. The following amounts are available for return on the rate base of $57,529,130.37: 1931, 3.45%; 1932, 3.70%; 1933, 2.12%; and twelve-months period ended March 31, 1934, 2.46%.

Facts set out under statement of the evidence show that even if the jury had accepted the commission's findings as to the rate base, annual depreciation reserve accrual, and operating expenses, they would have found that the 32 cent rate yielded 5.56% for 1931, 5.76% for 1932, 3.97% for 1933, and 4.31% for the twelve months ended March 31, 1934, or an average of 4.89% for return. (Page 41, *supra.*) It is apparent from the foregoing illustrations that if the jury found that appellant was entitled to a higher annual reserve accrual than the commission allowed or a minimum rate of 6%, as the commission found, or a rate of 7% or 8% for return, they were bound to find, as they did find, that the order of the commission was confiscatory and unjust and unreasonable as to appellant.

2. The application of the rate to appellant's intrastate operations, as determined by its segregation.

The only objection which the Court of Civil Appeals leveled at appellant's segregation was directed to the asserted error in treating the transportation of gas through Line A as interstate commerce. We have shown that the court's view in this regard was erroneous. (Pages 65 *et seq, supra.*) Whatever appli-

cation the court's criticisms of appellant's evidence in relation to its integrated operating system may have to appellant's segregation has already been sufficiently answered in the foregoing discussion. It has been sufficiently demonstrated, we think, that, in the exercise of their power to blend and weigh the evidence, the jury had a right to conclude that the commission's order was unjust and unreasonable as to appellant and that the rate prescribed by the order was confiscatory if applied alone to appellant's intrastate property and business.

The return yielded under the 32 cent rate, when applied to appellant's intrastate property and business, was shown to be 4.65% on the actual cost and 3.78% on the fair value (exclusive of going concern value) of appellant's intrastate properties, for the year 1933, after allowing for reserve accruals at the commission's rate of 2% per annum. (Pages 43-44, *supra.)*

3. The application of the rate to appellant's Texas properties and operations as segregated by the appellees.

Appellees introduced no evidence in relation to appellant's integrated operating system. The evidence which they introduced at the trial was based upon a segregation of the property and business between Texas and Oklahoma. This segregation in the main was based upon the geographical location of the property. (For discussion of appellees' segregation, see pages 44-47, *supra.*)

Appellees' expert found a reproduction cost new of appellant's integrated operating system of

$53,005,251.39 at December 31, 1931. He allocated $47,355,114.77 of that amount to the Texas properties. (III, R. 1797.) This is approximately 89.34% of the total value. This appraisal was not introduced in evidence by appellees, but was used by appellant at the trial for impeachment purposes. The jury had a right to take this figure into consideration in determining the value of the Texas properties if they felt the segregation formula employed by appellees at the trial was reasonable and proper. At the trial of this case the same expert testified to an evaluation of $40,256,862.39, (Appellees' Ex. 6; III, R. 2143) for the Texas properties alone, as of June 15, 1934. There is a difference between the two evaluations made by the same alleged expert of over $7,000,000.00 for Texas properties. Appellees' Exhibit 4 shows that from January 1, 1932, to March 31, 1934, the net capital additions to public service property in Texas alone amounted to $1,500,843.28. (III, R. 2125.) Prices for material and labor were higher as of June 15, 1934, than at December 31, 1933, the date of appellees' appraisal in this case. Thus, it is patent that the value ascribed to the Texas property by appellees' expert at June 15, 1934, is inconsistent with his prior determination. The pertinent facts would indicate a higher value at the later date because of net capital additions and increases in material prices and labor rate. The jury may have taken into consideration the disparity between the two appraisals by the same alleged expert and they may have given more weight to his first than to his second appraisal.

In passing upon the weight to be given appellees' evaluation of the Texas property which they submitted in this case, the jury had a right to take into consideration the following additional facts in reaching their conclusion as to the value of the Texas properties. Appellees' alleged expert, who made the evaluation, used prices prevailing as of January 1, 1933. He admitted that the net increase in prices from January 1, 1933, to June 15, 1934, on transmission line equipment alone amounted to $1,269,688.28. His appraisal does not give effect to this increase. (III, R. 1745-1746.) The witness could not give a breakdown of his cost in respect of the pipe lines. (III, R. 1769-1770.) He relied on information furnished by contractors in respect of the cost of hand excavation. (III, R. 1771-1772.) He had never had any experience in welding pipe lines, (III, R. 1778) or laying threaded and coupled pipe. (III, R. 1776-1777.) His appraisal did not include appellant's gas wells, gas well equipment, gas leaseholds, gas reserve or other production system property. (III, R. 1795-1796.) His appraisal did not represent his independent judgment based upon experience. (III, R. 1760-1762.) He had had no actual experience in designing, constructing or operating properties such as were included in his appraisal. (III, R. 1735, 1775-1776.) He had had no experience in laying natural gas pipe lines. (III, R. 1762.) The excavation costs which he used in preparing the appraisal were based on $.375 per cubic yard for machine excavation, whereas appellant's actual costs for machine excavation amounted to $.4646 per cubic yard. (III, R. 1923; Appel-

lant's Ex. 47, V, R. 3317.) Appellant's excavation costs were based on a labor rate of 35 cents per hour, whereas the rate prevailing at the date of inquiry was 40 cents per hour. (III, R. 1923-28.) The overhead or collateral construction costs applied in appellees' appraisal amounted to approximately 11.8%, (III, R. 2023), whereas experience shows such costs to run approximately 18%. (III, R. 2010.) The excavation costs used by appellees were 36.4% under excavation costs experienced by appellant. (Appellant's Ex. 47, V, R. 3317; III, R. 1925, et seq.)

The production system properties in Texas and which appellees eliminated from their appraisal in this case had an actual cost of $5,191,539.42. Not only were these properties eliminated from the appraisal, but the expenses incurred in their operation were also eliminated; and no sum was provided for depreciation and depletion thereon in the exhibit upon which appellees attempted to support the commission's order. The effect of these eliminations is discussed under the statement of the evidence, pages 46-50, *supra*.

The undisputed evidence showed the Texas production system properties to be used and useful in the Texas public service. (III, R. 2060.) Under the court's charge the jury were required to consider these properties in determining the rate base. The court instructed them that by the term "used and useful" was meant property of appellant's actually being used in the *production*, transportation, delivery and sale of natural gas to its customers. (Page 121, *supra*.) If the production system prop-

erties in Texas be added to appellant's appraisal at actual cost, it will result in a total value of $45,448,401.81. The jury could have properly adopted this figure as the rate base for Texas properties.

Appellee's witness testified that the actual cost of the Texas properties, as reflected by appellant's books, was $44,053,612.30 (Page 46, *supra*), exclusive of cash working capital, material and supplies, or going concern value. Appellees' appraisal included $1,289,000.00 for working capital on the Texas properties. (III, R. 2143.) If this sum be added to the actual cost, it results in a total of $45,342,612.30, exclusive of going concern value. Appellees' expert testified that $831,946.08 was a proper amount for annual depreciation reserve accruals. After correcting an error in his calculations, this amount was increased $16,600.00 (III, R. 1843), making a total of $848,546.08.

Appellees' estimate did not include any allowance for depreciation or depletion on the production system property. Appellees' witness testified that approximately $94,000.00 per annum should be allowed for this purpose. (III, R. 1913.) This makes a total annual reserve accrual on the basis of appellees' testimony, including the production system properties, of $942,546.08, which is 2.07% on appellees' appraisal, plus production system properties at cost. The jury may have accepted this figure. However, the jury may have accepted any of the other higher figures that we have heretofore referred to in discussing this subject.

The results obtained by blending appellees' evidence, to which we have just referred, are thus shown: The only exhibit relied on by appellees to show that the commission's order was reasonable and the rate prescribed thereby compensatory, was their Exhibit 8. (III, R. 2163-2174.) This exhibit shows $3,420,665.19 for the year 1933, and $3,608,172.77 for the twelve months ended March 31, 1934, available for depreciation, Federal taxes and return on the Texas properties under the 32 cent rate. These amounts were obtained by taking the actual revenues derived from Texas operations under the 40 cent rate as shown in appellees' Exhibit 4, and deducting therefrom the reduction occasioned by application of the 32 cent rate. The operating expenses used in this exhibit cover Texas operations only. None of the production system expenses are included. (III, R. 1903-1904.) The production system expenses amounted to $232,758.70 for 1933, and $222,752.66 for the twelve months ended March 31, 1934. (III, R. 2116-A.) After accounting for the production system expenses, there remained $3,187,906.49 for the year 1933, and $3,385,420.11 for the twelve months ended March 31, 1934, to provide for depreciation, Federal taxes and return. If the amount estimated by appellees' experts for depreciation and depletion reserve accruals be deducted from these amounts, there remains available for Federal taxes and return $2,245,360.41 for the year 1933, and $2,442,874.03 for the twelve months ended March 31, 1934.

Appellees estimated Federal income tax requirements for Texas operations alone at $96,073.64 for

1933, and $97,534.45 for the twelve months ended March 31, 1934. (Appellees' Ex. 8, III, R. 2174.) After deducting these amounts for Federal income taxes, there remains available for return $2,149,286.77 for 1933, and $2,345,339.58 for the twelve-months period ended March 31, 1934. In determining the weight to be given appellees' estimate for annual reserve accruals, the jury may have taken into consideration that the estimate was based upon the sinking fund method and presupposed the existence and use of a credit balance in the reserve account of $5,000,000.00 at the date of inquiry for transmission lines alone. (III, R. 1860-1861.) (Page 48, *supra.*)

When expressed as a percentage of a rate base determined by (1) taking appellees' appraisal of the Texas properties and adding the production system properties, and (2) a rate base determined by using the actual cost of the Texas properties plus cash working capital, the following is shown: (1) On the appraisal: 4.73% for the year 1933, and 5.16% for the twelve months ended March 31, 1934, for return; and (2) On basis of actual cost 4.74% for the year 1933, and 5.17% for the twelve months ended March 31, 1934, for return.

4. The application of the rate to appellant's Texas properties and operations, these properties being identified by applying appellees' formula of segregation to the entire integrated operating system; and discussion of the application of the rate to various bases of fact supported by the record.

The following computations are based on the finding of the Court of Civil Appeals that 85% of appellant's property is located in Texas. (V, R. 3337.) This finding conforms to appellees' segregation of the property between Texas and Oklahoma public service, appellees having determined that approximately 85% of the physical property is located in Texas. (III, R. 1748-1749.) Operating revenues and expenses have been allocated to Texas public service on the basis set up and used by appellees in their Exhibit 4. (III, R. 2116-A.)

Gross revenues under the 32¢ rate for Texas operations only have been determined by applying the 32¢ rate to the gas sales at Texas city gates, shown in Appellees' Exhibit 4. Expenses for the Texas operation alone have been taken from Appellees' Exhibit 4. In this manner the net amounts available for Federal income tax, depreciation, depletion and return for Texas operations alone were determined to be as follows:

12-31-31	$3,451,191.26
12-31-32	3,604,611.08
12-31-33	3,114,869.32
3-31-34	3,310,034.06

The depreciated actual book cost for the integrated operating system have heretofore been shown. (Page 155, *supra.*) Application of the finding that 85% of the property is located in Texas, gives a depreciated actual book cost for Texas properties of:

12-31-31	$39,471,706.42
12-31-32	41,280,583.87
12-31-33	41,122,420.50
3-31-34	41,151,051.77

If the 5% rate estimated by appellant's witness Connor for annual reserve accruals be applied to these depreciated book costs and deducted from revenues, the following percentages remain available for Federal income tax and return on Texas operations:

12-31-31	3.74%
12-31-32	3.73%
12-31-33	2.57%
3-31-34	3.04%

If the 3.09% estimated by appellees' witness for reserve accruals on the straight line method be applied to the depreciated book costs for the Texas properties, the following percentages remain available for Federal income tax and return on Texas operations:

12-31-31	5.65%
12-31-32	5.64%
12-31-33	4.48%
3-31-34	4.95%

We have heretofore shown that by taking appellant's determination of the fair value of the physical properties only in the integrated operating system and accepting the commission's findings for preliminary and organization expense and cash working capital on these properties, it results in a fair

value of $57,529,130.37, exclusive of going concern value. (Pages 156-7, *supra.*)

If the 85% factor be applied to this figure, it results in $48,899,760.81 for the fair value of the Texas properties only.

After applying the 5% rate estimated by appellant's witness for depreciation, depletion and amortization to these amounts, there remains available for Federal income tax and return on Texas operations the following percentages:

12-31-31	2.06%
12-31-32	2.37%
12-31-33	1.37%
3-31-34	1.77%

If the estimate of appellees' expert of 3.09% for depreciation, depletion and amortization be applied, there remains available for Federal income tax and return on Texas operations, the following percentages:

12-31-31	3.97%
12-31-32	4.28%
12-31-33	3.28%
3-31-34	3.68%

If the 85% factor be applied to appellant's determination of fair value for the integrated operating system in the amount of $69,738,021.16, it results in $59,277,317.99 for the fair value of the Texas property.

After applying appellant's estimate of 5% for annual depreciation reserve accruals, the following

percentages remain available for return on Texas operations:

12-31-31	.82%
12-31-32	1.08%
12-31-33	.25%
3-31-34	.58%

If the estimate of appellees' expert of 3.09% for depreciation, depletion and amortization reserve accruals be applied, the following percentages remain available for Federal income tax and return on Texas operations:

12-31-31	2.73%
12-31-32	2.99%
12-31-33	2.16%
3-31-34	2.49%

The foregoing computations exhibit reasonable and supportable blendings of the evidence that the triers of fact in any court empowered to adequately review the rate order might have applied to the evidence after determining the credibility of the witnesses and the weight to be given to their testimony. Thus we think it is clearly demonstrated that there was evidence in the record that the triers of fact in the District Court were entitled to credit and accept as constituting clear and satisfactory proof that the rate was confiscatory. If we be correct as to this, then their finding should stand. If it is not permitted to stand, then the decision to that effect must be based upon the rule announced by the Court of Civil Appeals denying the right of any court re-

viewing a rate order to settle conflicts in the evidence relating to matters and issues vitally affecting any correct decision of the issue of confiscation.

VII.

The judgment of the Court of Civil Appeals sustaining the rate order, challenged by appellant as being repugnant to the Constitution of the United States, should be reversed and the rate order adjudged to be void.

Respectfully submitted,

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OGDEN K. SHANNON,
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CHARLES L. BLACK,
Counsel for Appellant.

APPENDIX A.

(These articles are extracted from Texas Revised Civil Statutes, 1925.)

Art. 6053. Regulation of utilities.—The Commission after due notice shall fix and establish and enforce the adequate and reasonable price of gas and fair and reasonable rates of charges and regulations for transporting, producing, distributing, buying, selling and delivering gas by such pipe lines in this State; and shall establish fair and equitable rules and regulations for the full control and supervision of said gas pipe lines and all their holdings pertaining to the gas business in all their relations to the public, as the Commission may from time to time deem proper; and establish a fair and equitable division of the proceeds of the sale of gas between the companies transporting or producing the gas and the companies distributing or selling it; and prescribe and enforce rules and regulations for the government and control of such pipe lines in respect to their gas pipe lines and producing, receiving, transporting and distributing facilities; and regulate and apportion the supply of gas between towns, cities, and corporations, and when the supply of gas controlled by any gas pipe line shall be inadequate, the Commission shall prescribe fair and reasonable rules and regulations requiring such gas pipe lines to augment their supply of gas, when in the judgment of the Commission it is practicable to do so; and it shall exercise its power, whether upon its own motion or upon petition by any person, corporation,

municipal corporation, county, or commissioner's precinct showing a substantial interest in the subject, or upon petition of the Attorney General, or of any county or district attorney in any county wherein such business or any part thereof may be carried on.

Art. 6054. Orders, etc., reviewed.—All orders and agreements of any company or corporation, or any person or persons controlling such pipe lines establishing and prescribing prices, rates, rules and regulations and conditions of service, shall be subject to review, revision and regulation by the Commission on hearing after notice as provided for herein to the person, firm, corporation, partnership or joint stock association owning or controlling or operating the gas pipe line affected.

Art. 6059. Appeal from orders.—If any gas utility or other party at interest be dissatisfied with the decision of any rate, classification, rule, charge order, act or regulation adopted by the Commission, such dissatisfied utility or party may file a petition setting forth the particular cause of objection thereto in a court of competent jurisdiction in Travis County against the Commission as defendant. Said action shall have precedence over all other causes on the docket of a different nature and shall be tried and determined as other civil causes in said court. Either party to said action may have the right of appeal; and said appeal shall be at once returnable to the appellate court, and said action so appealed shall have precedence in said appellate court of all causes of a different character therein pending. If the court

be in session at the time such right of action accrues, the suit may be filed during such term and stand ready for trial after ten days notice. In all trials under this article the burden of proof shall rest upon the plaintiff, who must show by clear and satisfactory evidence that the rates, regulations, orders, classifications, acts or charges complained of are unreasonable and unjust to it or them.

Art. 1119. Rates prescribed, etc.—The governing body of all cities and towns in this State of over two thousand population, incorporated under the general laws thereof, shall have the power to regulate, by ordinance, the rates and compensation to be charged by all water, gas, light and sewer companies, corporations or persons using the streets and public grounds of said city or town, and engaged in furnishing water, gas, light or sewerage service to the public, and also to prescribe rules and regulations under which such commodities shall be furnished, and service rendered, and to fix penalties to enforce such charges, rules and regulations. The governing body shall not prescribe any rate or compensation which will yield less than ten per cent per annum net on the actual costs of the physical properties, equipment and betterments.


LONE STAR GAS CO.
PIPE LINE SYSTEM
LEGEND
WHEELER CO. TEXAS
SHAMROCK FIELD
PURCHASED & PRODUCED
6 448 138 M C F
(PART OF TEXAS PANHANDLE FIELD)
OKLAHOMA
TEXAS
LINE "A"
OKLAHOMA-TEXAS STATE LINE
HOLLIS
206 258 M C F
SNYDER
13 610 M C F
Line "A-1"
TIPTON
24 080 M C F
MANITOU
2 977 M C F
FREDERICK
75 756 M C F
DAVIDSON
6 474 M C F
MISCELLANEOUS
34 964 M C F
WEST TEXAS UTIL
1 713 035 M C F
CHILLICOTHE
27 845 M C F
TOLBERT
607 M C F
VERNON
35 414 M C F
OKLAUNION
4 458 M C F
HARROLD
3 753 M C F
ELECTRA
15 750 M C F
SHASTA OIL CO
139 107 M C F
IOWA PARK
24 341 M C F
WICHITA FALLS
672 149 M C F
MOUNTAIN PARK
4 880 M C F
LINE H & 2ND H
GAS CITY COM STA
27 764 M C F
CHICKASHA FIELD
PURCHASED & PRODUCED
734 629 M C F
DUNCAN FIELD
PURCHASED & PRODUCED
54 312 M C F
WALTERS
36 177 M C F
TEMPLE
22 077 M C F
MISC
18 641 M C F
HASTINGS
3 974 M C F
WAURIKA
35 730 M C F
BYERS
12 181 M C F
RYAN
32 120 M C F
PETROLIA
11 604 M C F
HENRIETTA
NET DEL AT PETROLIA 588 673 M C F
(LINES "H" & 2ND H)
NET DEL AT PETROLIA
3 381 496 M C F
(LINE A)
BELLEVUE
BOWIE
SUNSET
ALVORD
DECATUR
BRIDGEPORT
NEWARK
RHOME
SAGINAW
FT WORTH
DALLAS
PURCELL
MAYSVILLE
WYNNEWOOD
SULPHUR
LINE "G"
MARIETTA
DURANT
86 787 M C F
CADDO
5 231 M C F
Line "E-5"
Line "E-16"
ACHILLE
3 682 M C F
HUGO
40 590 M C F
GAINESVILLE
DENISON
SHERMAN
Line "E"
PARIS
TIOGA
McKINNEY
DENTON
SULPHUR SPRINGS
GREENVILLE
TERRELL
ATHENS
CORSICANA
MEXIA
WACO
CLEBURNE
GATESVILLE
ROSEBUD
CAMERON
COLLEGE STATION
ROUND ROCK
HAMILTON
VALLEY MILLS
SNYDER
ALBANY
ABILENE
SWEETWATER
COLORADO
CISCO
LAWN
WINTERS
BALLINGER